Court File No. CV-21-00659187-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c.C-36, AS AMENDED

AND DOMENICO SERAFINO AS A PERSON INTERESTED IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF HYDRX FARMS LTD., CANNSCIENCE INNOVATIONS INC. AND SCIENTUS PHARMA INC.

(the "Applicant")

BRIEF OF AUTHORITIES OF THE APPLICANT

(Re: Cobra Claim Process - Returnable June 30, 2021)

June 29, 2021

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COURT FILE NO.: CV-14-10684-00CL
DATE: 20180314

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:	
COSIMO BORRELLI, in his capacity as trustee of the SFC LITIGATION TRUST Plaintiff	*Robert Staley, Alan Gardner, Jonathan G. Bell, William A. Bortolin* and *Jason Berall* for the Plaintiff
– and –	
ALLEN TAK YUEN CHAN Defendant	*Robert Rueter, Sara J. Erskine, Malik Martin* and *David Barbaree* for the Defendant
	HEARD: March 6-10, 13-16, 20, 21, 23, 24, 27-29, and 31, April 3-7, 10-13, 18-22, 24-28, May 2-4, 8 and 9, June 8 and 9 and July 24-28, 2017

PENNY J.

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Overview

[1] This is an action by the SFC Litigation Trust against Allen Chan. Mr. Chan was the chief executive officer and chairman of the Board of Sino-Forest Corporation from 1994 to 2011. The claim is for damages of $2.6 billion for fraud, breach of fiduciary duty and negligence.

[2] Sino-Forest was a publicly traded company listed on the Toronto Stock Exchange. It suffered a catastrophic failure in 2011 following the publication of a negative analyst's report by Muddy Waters. The Muddy Waters Report accused Sino-Forest of being a Ponzi scheme, rife with fraud, theft and undisclosed related-party transactions.

[3] An Independent Committee of the Board was ultimately unable to disprove the principal Muddy Waters allegations. It was unable to establish that Sino-Forest held good title to $2.99 billion of standing timber plantations in mainland China which were recorded as assets in Sino-Forest's audited financial statements. It was unable to establish that Sino-Forest's counterparties in many standing timber and wood log trading transactions were arm's-length, partly because most of these counter parties disappeared or ceased to exist after publication of the Muddy Waters Report. The Independent Committee uncovered evidence that Mr. Chan and other members of senior management were involved in the management and control of some of these counterparties.

[4] As a result of information disclosed to the Ontario Securities Commission by Sino Forest and the Independent Committee, the OSC issued a cease trade order and later commenced enforcement proceedings against Sino-Forest and its senior management. This included Mr. Chan, George Ho, Alfred Hung, Albert Ip and Simon Yeung, all officers of Sino-Forest.

[5] Sino-Forest's secured debtholders initially tried to sell the assets of Sino-Forest but were unsuccessful. Sino-Forest eventually obtained a stay and restructuring orders under the *Companies' Creditors Arrangement Act*, R.S.C. 1985, c. C-36. By virtue of a plan of compromise approved by the Ontario Superior Court of Justice, the debtholders acquired the tangible assets of the company, which they later sold. Sino-Forest's rights of action were assigned to the SFC Litigation Trust. Cosimo Borrelli was appointed by the debtholders as Litigation Trustee.

[6] This action was commenced in April 2014. A trial was held in March, April and May 2017, with final argument taking place in July 2017. During the course of the trial, I attended in Hong Kong as a commissioner and took the evidence of a number of witnesses who lived there and in mainland China. A list of the witnesses who testified during the trial and on commission is attached as Appendix A to these Reasons.

[7] For the reasons that follow, the action for fraud and breach of fiduciary duty is allowed. I assess damages in the amount of $2,627,478,000.[1]

Background

[8] Sino-Forest Corporation was a reporting issuer in the province of Ontario. Its shares traded on the Toronto Stock Exchange. Sino-Forest's registered office was located in Mississauga, Ontario, and its executive office was located in Hong Kong. In these Reasons, I will use the term Sino-Forest to describe the Sino-Forest group, including operating subsidiaries, unless the context requires otherwise.

[9] Sino-Forest was an integrated forest plantation operator and forest products company with assets predominantly in the People's Republic of China ("PRC"). Its principal businesses included the ownership and management of forest plantations, the buying and selling of standing timber, wood logs and wood products and the complementary manufacturing of downstream wood products.

[10] By the end of 2010, Sino-Forest was focused on three core business segments. Standing timber operations and log trading were the primary revenue contributors, while manufacturing and other operations enhanced the value of the fibre operations by producing downstream products.

[11] Additionally, through a series of transactions that took place between July 2007 and September 2010, Sino-Forest acquired an indirect majority interest in the Greenheart Group, a Hong Kong listed investment holding company. Greenheart Group owned forestry rights and managed hardwood forest concessions in the Republic of Suriname and pine plantations in New Zealand.

Mr. Chan's Role at Sino-Forest

[12] Mr. Chan was a cofounder of Sino-Forest and was, from 1994 to 2011, its chief executive officer and chairman of the Board. Thomas Maradin, William Ardell and Brian Hyde all described Mr. Chan as a very hands-on CEO. Mr. Chan had ultimate control over nearly all aspects of Sino-Forest's operations. Mr. Chan's co-founder, K.K. Poon, by contrast, was described as "a figurehead." Operationally, Mr. Chan approved all plantation purchases and not only approved but signed all plantation sales contracts. Similarly, Mr. Chan approved, and in many cases signed, all of Sino-Forest's wood log trading contracts. Mr. Chan has never taken the position that, if there was a fraud, it was perpetrated by other members of senior management or other Sino-Forest employees without his knowledge. Rather, it has been Mr. Chan's position throughout this litigation, and throughout the trial, that there was no fraud and no breach of

[1] Unless otherwise stated, all references to currency are in USD, which is the currency in which Sino-Forest reported its financial results. In very approximate terms, from 2004 to 2011, Hong Kong dollars were in a relationship to USD of about 7 or 8:1 and RMB was in a relationship to USD of about 6 or 7:1.

fiduciary duty. Mr. Chan maintains that neither he nor any member of senior management have done anything wrong. He further maintains that all Sino-Forest's trading in standing timber plantations and wood logs was *bona fide*, producing valuable assets as reported in the company's audited financial statements.

Standing Timber Model

[13] From 2005 onward, Sino-Forest utilized two models for its standing timber business in the PRC. One involved subsidiaries incorporated in the British Virgin Islands ("BVIs") and the other involved subsidiaries incorporated in the PRC as wholly foreign owned enterprises ("WFOEs").

BVI Model

[14] Sino-Forest's BVI model was designed to circumvent restrictions on foreign companies carrying on business in the PRC. Foreign companies were not permitted to have PRC bank accounts, operate or sell timber plantations, or own land use rights in the PRC.

[15] Under the BVI model, Sino-Forest's BVI subsidiaries acquired standing timber from Suppliers. The Suppliers were represented as third party aggregators who acquired the standing timber rights from other suppliers or from original timber owners such as village collectives.

[16] The BVI subsidiaries (BVIs) did not acquire land use rights in the PRC. Instead, by means of standing timber purchase contracts, they acquired the rights to standing timber in the PRC.

[17] The BVIs did not sell standing timber directly to end-user customers. Instead, the BVIs conducted the sale of standing timber through "authorized intermediaries" ("AIs"). The AIs effectively served as the BVIs' customers under the BVI model.

[18] The BVIs did not directly pay the Suppliers or receive payments from the AIs. Instead, the AIs were instructed by Sino-Forest's management to make "set-off payments." Under these arrangements, the AIs were supposed to make payments directly or indirectly to the Suppliers for amounts owed by the BVIs to those Suppliers. As a result, no cash actually flowed through the BVI's or through Sino-Forest's bank accounts. The AIs were also responsible for the payment of all taxes applicable to the sale transactions. Sino-Forest received no concrete evidence, however, that these taxes had been paid.

[19] There were a number of negative features of the BVI Model. Chief among them was that profits on the purchase and sale of standing timber plantations were "locked up" in the PRC. This was because the BVIs, not being able to have bank accounts or conduct active business in the PRC, could not monetize the value of their holdings in standing timber and transfer that value out of the PRC. They could only plough trading profits back into the acquisition of more standing timber.

WFOE Model

[20] Commencing in 2004, the PRC's Ministry of Commerce permitted foreign investors to invest in PRC-incorporated trading companies (WFOEs) and to participate in the commodity distribution industry, including the purchase of standing timber and land use rights throughout the PRC. Prior to this time, WFOEs were prohibited from engaging in the commodity distribution industry.

[21] It was generally acknowledged within Sino-Forest management that, after the law changed to permit the use of foreign-owned PRC companies to own forestry assets, the WFOE model was "better" for Sino-Forest than the BVI model. Unlike Sino-Forest's BVIs, Sino-Forest's WFOEs could acquire plantation land use rights. WFOEs were able to harvest the timber and sell both logs and standing timber directly to end customers, meaning that WFOEs did not need to use AIs. Also, unlike BVIs, WFOEs could open PRC bank accounts, meaning that WFOEs could directly pay Suppliers and receive payments directly from customers. Accordingly, WFOEs did not need to utilize the set-off payments that were implemented under the BVI model. Profits on WFOE enterprises were not "locked up" in the PRC.

[22] Although WFOEs did not need to use AIs, Sino-Forest's WFOEs continued to sell forestry assets to AIs using set-off arrangements (rather than end-users, who would pay cash) due to the longstanding relationships the AIs had with Sino-Forest.

[23] The plantation land use rights regime also allowed WFOEs to plant standing timber plantations – an activity that the BVIs could not undertake with only standing timber rights. Sino-Forest therefore began operating "planted plantations" through the WFOE side of the business. The trading of standing timber alone was known as "purchased plantations," which was done through both BVIs and WFOEs. The planting of forests and holding them through to maturity/harvest was what was referred to as planted plantations. There is no allegation of impropriety with respect to the WFOE planted plantation business.

[24] After the law changed in 2004, Sino-Forest began looking for mechanisms to transfer assets held in the BVI model to the WFOE model. This process was called "on-shoring." Between 2004 and 2011, Sino-Forest conducted four small "pilot test" on-shoring transactions, all of which took place in 2009. No successful method was discovered to achieve "on-shoring" by June 2011.

Wood Log Trading Model

[25] Under the wood log trading model, a Sino-Forest BVI subsidiary purchased logs from a Supplier outside the PRC. To pay for those logs, the BVI subsidiary obtained a U.S. dollar denominated letter of credit, typically payable within 90 days. Sino-Forest guaranteed the letter of credit. The Supplier delivered the logs and the Sino-Forest BVI would resell the logs to a Sino-Forest customer.

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The Relative Growth and Significance of Sino-Forest's Business Models

[26] Sino-Forest's financial statements reported exceptional growth from 2003 until the second quarter of 2011. Between the 2003 and 2010 financial year ends, Sino-Forest's total reported assets increased by 1,268% and its total reported revenues increased by 624%.

[27] The BVI standing timber model was, by far, the predominant contributor to the Sino-Forest Group's reported assets, revenue and profit. The BVI model accounted for about: (a) 49% of the Sino-Forest's total reported assets from 2005 to 2006; (b) 70% of the Sino-Forest's total reported assets from 2007 to 2010; and (c) 94% of the Sino-Forest Group's reported profits from 2007 to 2010. The growth of the BVI model assets was critical to Sino-Forest's success. By contrast, the impact of the WFOE and wood log trading models on the Sino-Forest's revenues and profits was relatively inconsequential. In 2011, the WFOE model incurred a net loss.

Sino-Forest's Cash Raises on the Capital Markets

[28] Between August 2004 and October 2010, Sino-Forest raised approximately $2.929 billion through debt financing in the form of senior notes and a loan (totalling $1.855 billion) and equity financing (totalling $1.074 billion). Sino-Forest incurred share issue costs of $42.053 million and debt issue costs of $60.813 million. Sino-Forest also made debt principal repayments of $237.670 million between 2009 and 2011. The net cash proceeds available from the capital raises therefore totalled $2.588 billion.

The Muddy Waters Report

[29] On June 2, 2011, a short seller, Carson Block, and his research company, Muddy Waters LLC, released a report on Sino-Forest (the "Muddy Waters Report"). The Muddy Waters Report alleged that Sino-Forest committed several frauds and described Sino-Forest as a "multi-billion dollar Ponzi scheme ... accompanied by substantial theft."

[30] Among other things, the Muddy Waters Report alleged that: (a) Sino-Forest did not hold the full amount of timber assets that it reported; (b) Sino-Forest overstated its revenue; and (c) Sino-Forest had engaged in undisclosed related-party transactions, including with Yuda Wood, Sino-Forest's largest supplier of standing timber between 2007 and 2010. It was alleged that Yuda Wood was secretly controlled by Sino-Forest insiders.

The Independent Committee Investigation and Other Consequences of the Muddy Waters Report

The Independent Committee Investigation

[31] The day the Muddy Waters Report was released, Sino-Forest's Board appointed an Independent Committee (the "IC") to investigate the allegations made in the Muddy Waters Report. The IC was composed of three independent, outside Canadian directors of Sino-Forest: Messrs. Bowland, Ardell, and Hyde. The IC, in turn, retained independent legal and financial

advisors in Canada, Hong Kong and the PRC to investigate the issues raised in the Muddy Waters Report. The IC advisors were deployed to Hong Kong and the PRC to carry out their investigation.

[32] The IC issued three reports setting out its findings. The IC advisors also released their own reports. As set out in the IC's first report dated August 10, 2011, the IC focused its review on the existence and value of Sino-Forest's reported timber holdings and Sino-Forest's relationship with its Suppliers and customers under the BVI model.

[33] From the outset of its investigation, the IC and its advisors sought the full cooperation and support of Sino-Forest's senior inside management. This included Mr. Chan, Alfred Hung, George Ho, Albert Ip, Simon Yeung, Yosanda Chiang (Mr. Chan's executive assistant) and others. I will use the term "Inside Management" collectively to refer to these people. There is an issue about the degree and extent to which Inside Management co-operated with the IC and its advisors.

[34] In 2010, Sino-Forest recorded $1.4 billion in revenue from plantation fibre operations of which $1.3 billion was generated through BVI standing timber trading. Over 90% of 2010 income (of $620 million) was generated from BVI standing timber trading. While wood log trading generated significant revenue (over $450 million in 2010), this segment of Sino-Forest's functions only accounted for $15.8 million of income. Wood log trading, therefore, was a low profit margin investment compared to BVI standing timber model. Thus, Sino-Forest's core activity was trading in standing timber plantations using the BVI model; this was the central driver of asset value, revenue and income for Sino-Forest.

[35] The starting point for the IC investigation was to determine whether Sino-Forest owned the billions of dollars of BVI standing timber assets recorded in its audited financial statements. Accordingly, the IC asked to see the contracts underlying the BVI assets. The purchase contracts stated that plantation rights certificates and villagers authorization were attached, which would have confirmed Sino-Forest's legal title to the standing timber. However, the plantation rights certificates and villagers authorization were not attached to any of its BVI standing timber contracts and Sino-Forest did not have any of these documents.

[36] Instead, to confirm Sino-Forest's "title" to its BVI standing timber, Sino-Forest had what were described as forestry bureau confirmations. The IC advisors set out to speak to the forestry bureaus to confirm the legitimacy of the confirmations. However, management expressed strong concerns about approaching the forestry bureaus, claiming that the confirmations were "confidential" and "could embarrass the forestry bureau officials."

[37] The IC advisors then sought to obtain new confirmations from the forestry bureaus. However, new confirmations were only issued in four instances. In those four instances, the new confirmations did not confirm ownership of the BVI standing timber assets but only recognized the contractual relationship between Sino-Forest and its Supplier.

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[38] Since Sino-Forest did not have any of the documentation necessary to establish title to the BVI standing timber or that its transactions with its BVI counterparties actually took place (since no cash flowed through Sino-Forest's accounts under the BVI model), the IC sought to set up meetings with Sino-Forest's BVI Suppliers and AIs to see if they had documentation to establish the validity of Sino-Forest's BVI standing timber assets. All of the Suppliers and AIs who were asked, refused or were otherwise unable to produce any documentation of ownership or banking records indicating they had paid or received payment by way of the set offs directed by Sino-Forest.

[39] The IC also discovered documentary evidence of close relationships between Sino-Forest and some of its BVI standing timber counterparties, including a company called Yuda Wood. Mr. Chan and other members of Inside Management were interviewed by the IC advisors from August 24 to 26, 2011 regarding these documents. The answers given were unsatisfactory to the IC and its advisors; the documents were provided to the OSC.

The OSC Temporary Cease Trade Order Requiring Mr. Chan and Inside Management to Resign

[40] On August 26, 2011, the OSC issued a temporary cease trade order. The order set out the OSC's allegations, including that: (a) Sino-Forest appeared to have engaged in significant non-arm's length transactions; (b) Sino-Forest and certain of its officers and directors appeared to have misrepresented some of its revenue and/or exaggerated some of its timber holdings; and (c) Mr. Chan and others appeared to be perpetrating a fraud. As a result, the OSC ordered, among other things, that all trading in the securities of Sino-Forest cease and that Mr. Chan and senior management resign.

[41] Following the OSC's temporary order, Mr. Chan stepped down as Chairman and CEO of Sino-Forest and was given the title Founding Chairman Emeritus. In that capacity, Mr. Chan remained on Sino-Forest's premises and occupied his usual office. Although he gave up his executive authority, Mr. Chan remained available to assist with the investigation when required.

[42] On August 28, 2011, Sino-Forest issued a press release announcing the change in Mr. Chan's role and that the members of senior management had been placed on administrative leave.

The Failure to Issue Sino-Forest's Third Quarter 2011 Financial Statements and Default Under the Notes

[43] November 14, 2011 was the deadline for Sino-Forest to release its third quarter 2011 financial statements (Q3 Results). As the deadline approached, Sino-Forest's Audit Committee consulted with its advisors about whether to defer the release of the Q3 Results until certain issues could be resolved to the satisfaction of the Board and Sino-Forest's auditor.

[44] The Audit Committee's primary concern was that Sino-Forest's management remained unable to provide satisfactory explanations of documents appearing to indicate that there were connections between Sino-Forest and certain of its AIs and Suppliers. The Audit Committee did not have sufficient comfort that the financial statements could be presented fairly and accurately.

The Audit Committee, therefore, made a recommendation against release of the Q3 Results. On November 15, 2011, Sino-Forest issued a press release stating that it was deferring the release of the Q3 Results for a 30 day period.

[45] Sino-Forest's failure to file the Q3 Results and provide a copy of the Q3 Results to the noteholders through their trustee under senior and convertible note indentures by November 14, 2011, constituted a default. Under the indentures, an event of default would occur if Sino-Forest failed to cure that breach within 30 days in the case of the senior notes, and 60 days in the case of the convertible notes, after having received written notice of default from the relevant indenture trustee.

[46] On December 12, 2011, Sino-Forest issued a press release explaining that it was not going to be in a position to release the Q3 Results within the 30-day period set out in its November 15 press release. Sino-Forest further announced in that, in the circumstances, there was no assurance that it would ever be able to release the Q3 Results, or, if able, when the release might occur.

[47] Sino-Forest then failed to make a $9.775 million interest payment on the 2016 convertible notes that was due on December 15, 2011. This failure constituted another event of default under the indentures.

[48] On December 18, 2011, Sino-Forest announced that it had received written notices of default in respect of its senior notes due 2014 and its senior notes due 2017. The notices, which were sent by the trustees under the senior note indentures, referenced Sino-Forest's previously-disclosed failure to release the Q3 Results on a timely basis. Sino-Forest reiterated in the December 18, 2011 press release that it did not expect to be able to file the Q3 Results or cure the default within the 30-day cure period.

[49] In response to the receipt of the notices of default, on December 16, 2011 the Board established a Special Restructuring Committee of the Board (the Restructuring Committee), comprised exclusively of directors independent of management of Sino-Forest, for the purpose of supervising, analyzing, and managing strategic options available to Sino-Forest. The members of the Restructuring Committee were Ardell, who was appointed Chair of the Restructuring Committee, and Garry West.

[50] Following further discussions with its external auditors, E & Y, on January 10, 2012 Sino-Forest issued a press release cautioning that its "historic financial statements and related audit reports should not be relied upon."

The Third Report of the IC

[51] In its third and final report released on January 31, 2012, the IC disclosed that the issues it examined, including timber asset verification and related party transactions and relationships, "proved very difficult to definitively resolve."

The CCAA Proceedings and the Formation of the Sino-Forest Litigation Trust

The Restructuring Support Agreement

[52] Following extensive negotiations, Sino-Forest and an ad hoc committee of noteholders agreed on a framework for a consensual resolution of Sino-Forest's defaults and the restructuring of its business. These parties entered into a Restructuring Support Agreement on March 30, 2012 (the "Support Agreement").

[53] The Support Agreement contained summary terms and conditions for a going concern restructuring of Sino-Forest whereby ownership of Sino-Forest's business would be transferred to the noteholders, who had first priority security interests over the shares of Sino-Forest's subsidiaries. The Support Agreement provided that, prior to entering into the restructuring transaction, Sino-Forest would undertake a sale process (the "CCAA Sale Process").

[54] The CCAA Sale Process was intended to function as a market test through which third parties would propose to acquire Sino-Forest's business operations through a CCAA plan. This would enable Sino-Forest and its stakeholders to determine if the value of Sino-Forest's assets exceeded the debt owed to the noteholders (thus rendering it unfair to transfer ownership to the noteholders under the restructuring transaction). Accordingly, the restructuring transaction would only proceed if the CCAA Sale Process was unsuccessful.

[55] On March 30, 2012, Sino-Forest filed for and obtained protection under the CCAA. Under the Initial Order of Mr. Justice Morawetz (as he then was), FTI Consulting Canada Inc. ("FTI") was appointed as the Monitor. Justice Morawetz also granted a Sales Process Order authorizing Sino-Forest to conduct the CCAA Sale Process.

The OSC Enforcement Notice

[56] On April 5, 2012, Sino-Forest received an Enforcement Notice from the OSC. On April 17, 2012, Sino-Forest announced that: (a) it had terminated the employment of Hung, Ho, and Yeung; (b) Ip, who had previously resigned, would no longer be serving as a consultant; and (c) Mr. Chan had voluntarily resigned as Founding Chairman Emeritus.

[57] On May 22, 2012, Sino-Forest received the OSC's Statement of Allegations. The OSC alleged that Mr. Chan and senior management "engaged in a complex fraudulent scheme to inflate the assets and revenue of Sino-Forest" and that Mr. Chan "also committed fraud in relation to Sino-Forest's purchase of a controlling interest in a company now known as Greenheart Group Limited."

The Failed CCAA Sales Process

[58] Sino-Forest retained the global investment bank Houlihan Lokey Capital ("Houlihan") to act as its financial advisor for the CCAA Sales Process.

[59] Under the Sales Process, Sino-Forest and Houlihan, under the supervision of the Monitor, solicited non-binding letters of intent for the sale of Sino-Forest's assets. To be considered, a letter of intent had to offer consideration not less than 85% of approximately $1.8 billion, being the aggregate principal amount of the notes plus all accrued and unpaid interest on the notes up to and including March 20, 2012.

[60] Houlihan, in consultation with Sino-Forest and the Monitor, selected a group of 85 potential buyers and provided those parties with a "teaser" letter. That led to the negotiation of confidentiality agreements with 14 parties who indicated an interest in purchasing Sino-Forest's assets. Interested parties were granted access to a robust data room containing everything in Sino-Forest's possession, including legal documents, financial statements, BVI and WFOE contracts, plantation rights certificates for WFOE plantations, forestry bureau confirmations for BVI plantations, verification reports, reports from an independent forestry consultant, Indufor Asia Pacific Ltd. ("Indufor"), and PRC-based legal opinions with respect to Sino-Forest's ownership of its forestry assets.

[61] Only four bidders submitted non-binding letters of intent. None of the four letters came close to the threshold of 85% of $1.8 billion (i.e., $1.53 billion). The offers set out in the four letters of intent were:

- $200-300 million cash;
- $550-650 million worth of debt and equity;
- $115 million of cash and a to-be-determined amount of equity in a new company that would own the assets; and
- $100 million of cash and the cash that remained in Sino-Forest's bank accounts at the time of the sale, which at the time of the offer was $364 million.

[62] Since none of the letters of intent came close to the threshold of 85% of Sino-Forest's noteholder debt, Sino-Forest issued a press release on June 10, 2012, announcing that the CCAA Sale Process was terminated. The Monitor concurred that the termination of the CCAA Sales Process was appropriate.

Difficulties in Collecting Sino-Forest's Receivables and Confirming the Existence and Legitimacy of Sino-Forest's Purported Counterparties

[63] As of March 30, 2012 (the date of the Initial Order), Sino-Forest's accounts receivable totalled approximately $1.1 billion comprised of: (a) $76.9 million owing to WFOE subsidiaries of Sino-Forest; (b) $887.4 million owing to BVI subsidiaries of Sino-Forest from AIs purportedly arising from the sale of standing timber; and (c) $126.2 million owing to BVI subsidiaries of Sino-Forest from wood log trading customers.

[64] One of the Monitor’s roles was assisting with the collection of receivables. According to Sino-Forest’s financial statements from 2005 until the second quarter of 2011, Sino-Forest had always collected 100% of its receivables. After the commencement of the CCAA proceedings, the Monitor did not collect a single BVI or wood log trading receivable and only collected approximately $100,000 of the total outstanding receivables.

[65] As part of the Monitor’s efforts to locate and verify the existence of Sino-Forest’s standing timber assets, the Monitor sought to contact BVI standing timber Suppliers to verify what Sino-Forest had purchased and identify the location of the standing timber. However, the Monitor had little success making contact with any of the Suppliers.

Write-Down of Wood Log Deposits

[66] In the course of Sino-Forest’s wood log trading business, Sino-Forest made deposits from time to time. The majority of these deposits were written down following the commencement of the CCAA proceedings. In particular, Sino-Forest recorded an impairment charge of $108 million, representing roughly 70% of the outstanding wood log deposits as of December 31, 2011.

[67] The remaining balance related primarily to deposits paid to a company called Xunxiang for the supply of redwood. Despite efforts made throughout the CCAA proceedings, the Monitor was unable to secure the redwood or the return of the deposits.

The Area Verification Process

[68] During the course of the IC investigation, Sino-Forest engaged Indufor, a forestry consulting company, to undertake an area verification of Sino-Forest’s claimed forestry estate. After the commencement of the CCAA proceedings, Indufor continued its work under the oversight of the Monitor.

[69] Indufor required maps in order to carry out its area verification work. Indufor obtained 93% of the necessary maps for WFOE planted plantations and 44% of maps for WFOE purchased plantations with land leases. However, no maps for WFOE purchased plantations without land leases were forthcoming. More importantly, given the magnitude of the BVI standing timber business, maps for only 1% of BVI plantations were ultimately obtained. The BVI maps that Indufor was able to obtain did not come from Sino-Forest’s records or directly from forestry bureaus but were produced by Sino-Forest’s management.

[70] As a result of the inability to obtain the required maps for the BVI assets, Sino-Forest eventually instructed Indufor to discontinue further area verification work on the basis that, without the maps, it was impossible to verify the location and existence of the assets. The Monitor and the bondholders agreed with the decision to terminate Indufor’s area verification process.

The Noteholders' Forestry Experts had no More Success than Indufor

[71] The ad hoc committee of noteholders also retained their own forestry experts, Chandler Fraser Keating ("CFK"). CFK issued a report in September 2012. It concluded there was virtually no one who knew the exact location of the forests and that the forestry bureaus would not be able to assist as there was insufficient documentation in the sale and purchase agreements for anyone to locate the forests.

The CCAA Plan and the Formation of Emerald and the Litigation Trust

[72] On December 10, 2012, the Court granted an order sanctioning Sino-Forest's Plan of Compromise and Reorganization (the "Plan"). Under the Plan, effective January 30, 2013 all of Sino-Forest's assets, including its interest in its directly owned subsidiaries, were transferred to Emerald Plantation Group Limited ("EPGL"), a wholly-owned subsidiary of Emerald Plantation Holdings Limited ("EPHL"). Both entities were created for the purpose of holding Sino-Forest's assets following the implementation of the Plan.

[73] In addition, most of Sino-Forest's litigation claims were transferred to a Litigation Trust. Mr. Borrelli was appointed as trustee of the Litigation Trust.

Emerald's Attempts to Sell Sino-Forest's Assets

[74] Prior to the implementation of the Plan, on September 8, 2012, Paul Brough was appointed as the Chief Restructuring Officer of Sino-Forest. It was envisaged at the time that Brough would become the CEO of EPHL.

[75] For the purposes of planning the repayment of Sino-Forest's debts through a restructuring, one of Brough's primary tasks was categorizing Sino-Forest's assets into "good bank" and "bad bank" assets. The "good bank" assets were those that had value and were potentially saleable or realizable. The "good bank" assets primarily included:

- the cash balances of the WFOE subsidiaries in the PRC which had been transferred to them as loans or to provide share capital;
- the WFOE plantations held primarily by subsidiaries of Sino-Wood and, to a lesser extent, by subsidiaries of Sino-Panel where plantation rights certificates were available;
- certain of the manufacturing facilities in the PRC, primarily owned by Sino-Wood;
- the nursery business in the PRC;
- various properties located in the PRC; and

- Sino-Forest's interest in Greenheart Group Limited ("Greenheart") and Greenheart's subsidiary, Greenheart Resources Holdings Limited ("GRHL").

[76] The "bad bank" assets comprised the balance of Sino-Forest's assets, to which no value was ascribed for the purpose of identifying sources of repayment. The "bad bank" assets included the BVI standing timber assets and related receivables. The key issues with the BVI standing timber assets and associated receivables, from Brough's perspective, were:

- the inability of Sino-Forest's and the many professionals' to locate the vast majority of the BVI standing timber;
- the lack of any evidence of ownership of the BVI standing timber; and
- the difficulties that would arise from any attempt to realize value from the BVI standing timber, even if the assets could be located and title proved.

Write-down of the BVI Standing Timber Assets and Receivables

[77] EPHL's first published interim financial statements were for the period December 14, 2012 (the date of EPHL's incorporation) until June 30, 2013. Although unaudited, the financial statements were prepared to provide a true and fair view of the assets of EPHL in accordance with accounting standards. EPHL's board also consulted with EPHL's auditors, KPMG, about the proposed carrying value of the assets.

[78] EPHL's board resolved that no value would be ascribed to the BVI standing timber assets and associated receivables in the interim financial statements. EPHL's board also considered it prudent to write down the value of certain forestry assets, and wrote off receivables and deposits arising from the wood log trading business formerly conducted by Sino-Forest.

[79] Similarly, in EPHL's annual financial statements for the year ended December 31, 2013, which were audited, a zero value was attributed to the BVI standing timber assets and related receivables.

EPHL Seeks to Sell its Assets

[80] The goal of EPHL's board was to achieve maximum recovery for EPHL's shareholders (who are Sino-Forest's former noteholders) by addressing the issues with the business and selling it for the highest achievable value in the circumstances.

[81] After Sino-Forest's assets were transferred to EPHL on January 30, 2013 under the Plan, the EPHL board resolved that the best course of action was to dispose of EPHL's assets *en bloc* through a sale of EPGL.

The Goldnet Deal

[82] On May 13, 2013, EPHL signed a sale agreement with Goldnet Worldwide Limited for the sale of EPHL's shares in EPGL. Goldnet was introduced through Mr. Chan, who attended a number of meetings in relation to the proposed sale.

[83] The discussions with Goldnet continued for a number of months but made little progress towards a conclusion. During this time, there was a monthly cash burn of about $10 million to fund the continued holding of Sino-Forest's assets. The "good bank" assets were not being put up for sale or being realized.

[84] Very little of the $10 million monthly cash burn was spent on BVI assets because, unlike other aspects of Sino-Forest's business, there were no ongoing expenses with respect to the BVI assets. The only expense that related to the BVI assets was insurance, which Brough stopped because he did not think the assets existed.

[85] In September 2013, after four months during which little progress had been made, EPHL's board terminated the sale agreement as Goldnet had failed to secure financing necessary to complete the transaction.

The Sale of Greenheart to Newforest

[86] Following the termination of the Goldnet deal, EPHL sought to dispose of the former Sino-Forest assets on a piecemeal basis.

[87] A formal agreement for the sale of Greenheart was entered into on October 31, 2014 between EPHL and Newforest Limited ("Newforest"). Newforest is 40% owned by Gateway Asia Resources Limited, which is a wholly-owned company of Danny Wu, and 60% owned by Sharpfield Holdings Limited, which is a wholly-owned subsidiary of Chow Tai Fook Enterprises Limited. Mr. Chan acted as a consultant to Newforest during the negotiation of the deal.

[88] Upon the closing of the sale in May 2015, EPHL received $108.5 million for its interest in the Greenheart business.

The Sale of EPGL to New Plantation and the Recovery Assets Program Agreement

[89] Following the completion of the Greenheart sale, EPHL conducted a marketing campaign and reached out to potential buyers to explore a sale of the remainder of EPHL's assets. A number of miscellaneous assets worth approximately $36.383 million were sold.

[90] After extensive negotiations over the course of 2015, on December 2015, EPHL signed a term sheet with New Plantations Limited ("New Plantations"), which is also owned by Danny Wu and Chow Tai Fook. The agreement for the acquisition of EPGL between New Plantations and EPHL was executed on April 21, 2016. Similar to the Greenheart deal with Newforest, Mr. Chan was an advisor to New Plantations during the negotiation of this deal.

[91] Under the terms of the EPGL Acquisition Agreement, New Plantations agreed to pay EPHL:

- net consideration of $208,284,666 in cash (although $208,306,736 was actually received after minor adjustments);
- deferred consideration of $23 million to be paid 12 months after completion net of any claims by New Plantations; and
- approximately $5,036,570 which had been frozen by certain Court orders, upon recovery of those funds.

[92] In connection with the sale of EPGL, EPHL also entered into a Recovery Asset Program Agreement with New Plantations dated June 7, 2016 (the "RAPA"). Under the RAPA, if New Plantations successfully recovers any of EPGL's assets that were written down to zero, New Plantations is obligated to pay a portion of the recovered amounts to EPHL. In connection with the RAPA, New Plantations paid a non-refundable advance payment to EPHL of $2.5 million.

[93] The zero-value assets covered by the RAPA are categorized either as "General Recovery Assets" or "Special Recovery Assets":

[94] The General Recovery Assets include BVI standing timber, BVI standing timber receivables, wood log receivables, wood log deposits, Sino-Panel receivables, and a tax refund. Under the RAPA, if New Plantations recovers any General Recovery Assets, EPHL is entitled to (net of costs) 40% of the first $50 million, 30% of the next $150 million, and 20% of any recoveries in excess of $200 million.

[95] The Special Recovery Assets include the proceeds from an arbitration award in favour of Sino-Forest against a company called Xunxiang. The Xunxiang arbitration proceeds were categorized as a Special Recovery Asset because EPGL had already received an arbitral award and frozen $12.5 million of Xunxiang's assets by means of a *Mareva* injunction. The other Special Recovery Assets are WFOE plantations to be received pursuant to claim settlements and proceeds of ongoing legal proceedings in relation to individual wood-log purchase contracts, which EPHL considered more likely to be recoverable in the near term. Under the RAPA, if New Plantations recovers any Special Recovery Assets, EPHL is entitled to 80% of the proceeds (net of costs).

[96] As required by the RAPA, EPHL and New Plantations have quarterly meetings in which New Plantations updates EPHL on the progress under the RAPA. To date, other than the frozen $12.5 million on account of the Xunxiang arbitration award (80% of that amount is $10 million), there have been no recoveries net of costs under the RAPA.

Document Gathering

[97] Steven Henderson was one of the lead forensic accountants for PWC which was retained as an advisor by the IC. He testified that, early in the IC process, PWC identified 23 key custodians who were likely to have information that would be important to the investigation. This included Ip, Hung, Mr. Chan, Ho, K.K.Poon and Yosanda Chiang. In general terms, PWC worked with Sino-Forest's information technology employees to understand how Sino-Forest's system worked, what personal devices each of the custodians might have and what other methods of communication the custodians used. PWC then collected that information and imaged it.

[98] PWC found that Sino-Forest had two separate IT systems, one in China and one in Hong Kong. In China, there were several separate servers which were not integrated. As Sino-Forest did not have one overall central server, the data collection exercise was time-consuming and difficult. Notwithstanding these difficulties, by August 2011 the IC advisors were able to capture, assemble and organize a massive amount of data including:

(a) corporate particulars for all the Sino-Forest subsidiaries and corporate searches of the authorized intermediaries (AIs) and other third parties;

(b) electronic data from Sino-Forest servers, backup tapes and user computers and personal devices of more than 120 Sino-Forest personnel;

(c) BVI timber purchase and sale contracts;

(d) WFOE purchase and sale contracts;

(e) plantation rights certificates for WFOEs;

(f) forestry bureau confirmations;

(g) valuation reports;

(h) Sino-Forest legal advice; and

(i) other information about various business segments.

[99] All of the imaged hard drives and devices were provided to Bennett Jones LLP, then counsel to Sino-Forest, on July 25, 2012. Bennett Jones was in possession of the books and records of Sino-Forest as a result of their representation of Sino-Forest following the Muddy Waters Report.

[100] Upon Mr. Borrelli's appointment on January 30, 2013, he obtained all the books and records that were in the possession of Bennett Jones, as well as documents from EPHL and other, publicly available, sources.

[101] The information received by Mr. Borrelli included:

(a) forensic images of electronic storage media taken from Sino-Forest's Canadian and Hong Kong offices. This included storage media imaged from hard drives from servers desktops and laptops and from hand-held devices such as Blackberries. These images were catalogued by reference to the custodian of the relevant electronic storage medium and stored on hard drives;

(b) various documents collated by the IC; and copies of paper documents that had been located in Sino-Forest's Canadian and Hong Kong offices.

[102] Documentation from EPHL included:

(a) copies of paper documents located in Sino-Forest Canadian and Hong Kong offices and warehouses located in Hong Kong and in the PRC;

(b) various Sino-Forest files and mail servers kept at EPHL's Hong Kong and Guangzhou offices.

[103] The defendant did not take issue with the authenticity of the documents introduced at trial or with the "chain of custody." Certain objections were made about the use to which many of these documents could be put, mostly on the basis of hearsay and/or fairness grounds. I made rulings before, during and after the trial on the issues of admissibility.

[104] I should add, while on the subject of documents, that this proceeding was conducted as a "paperless" trial. As a result of a pretrial endorsement made by me, all of the evidence in chief was prefiled by way of affidavit. Examinations in chief were relatively short, with most of the *viva voce* evidence focused on cross-examination. While a few paper exhibits were filed, virtually all of the documentary evidence was both filed and used during the trial in electronic form only. Paper exhibits, even with joint books of documents, would have vastly complicated and extended the length of the trial. The use of electronic material was, therefore, essential to the timely completion of the trial. I wish to express my gratitude to all of the lawyers, and their technology support personnel, for their part in having the trial proceed electronically on a relatively seamless basis. The trial was also conducted using "real time" court reporting. This took place both in Toronto and while taking commission evidence in Hong Kong. I also wish to express my gratitude to all the reporters for their tireless efforts and high quality work.

Preliminary Issues

[105] Before turning to the main allegations in this case, it is necessary to address four important issues, each of which affects, in one way or another, the overall analysis of the conduct and the impugned transactions in issue. Those issues are:

a) class action duplication;
b) affirmation;

c) the standard of proof; and
d) document translation.

Class Action Duplication

[106] The defendant's argument about duplication arises from the plaintiff's status as an assignee, having only claims belonging to Sino-Forest which were specifically assigned to the plaintiff by the CCAA Plan Sanction Order. The defendant argues that the Litigation Trust claims do not include claims advanced in another proceeding, the noteholder and investor class action, and that the amended statement of claim in this case asserts claims which are duplicative of the claims advanced in that class action. For this reason, he argues, the plaintiff's claims must be dismissed.

[107] The starting point for this argument is not contentious. The plaintiff's status is determined by the CCAA Plan Sanction Order and the Litigation Trust Agreement. The plaintiff itself pleads (in paras 12 and 13 of the amended statement of claim) that the Litigation Trust Agreement and the CCAA Plan Sanction Order transferred certain "Litigation Trust Claims" to the Litigation Trust. Those claims included all claims which "have been or may be asserted by or on behalf of" Sino-Forest against any third parties *other than*, i) any claim released by Article 7 of the CCAA Plan or, ii) any "Excluded Litigation Trust Claims." An Excluded Litigation Trust claim is a claim Sino-Forest and the noteholders agreed, before the Plan implementation date, would be excluded from the claims transferred to the Litigation Trust.

[108] How these provisions apply on the facts, however, is highly contentious indeed.

[109] The "purpose and effect" of the Plan is set out in s. 2.1:

> The purpose of the Plan is:
>
> (a) to effect a full, final and irrevocable compromise, release, discharge, cancellation and bar of all Affected Claims;
>
> (b) to effect the distribution of the consideration provided for herein in respect of Proven Claims;
>
> (c) to transfer ownership of the Sino-Forest business to Newco and then from Newco to Newco II, in each case free and clear of all claims against Sino-Forest and certain related claims against the Subsidiaries, so as to enable the Sino-Forest Business to continue on a viable, going concern basis; and
>
> (d) to allow Affected Creditors and Noteholder Class Action Claimants to benefit from contingent value that may be derived from litigation claims to be advanced by the Litigation Trustee.

[110] Section 4.4 of the Plan compromises most claims against Sino-Forest but contemplates the preservation of certain class action claims against specified defendants, which include Mr. Chan. Section 4.4(b) of the Plan provides:

> Notwithstanding anything to the contrary in section 4.4(a), Noteholder Class Action Claims as against the Third Party Defendants (x) are not compromised, discharged released cancelled or barred, (y) shall be permitted to continue as against the Third Party Defendants and (z) shall not be limited or restricted by this Plan in any manner as to quantum or otherwise (including any collection or recovery for such Noteholder Class Action Claims that relates to any liability of the third-party defendants for any alleged liability of Sino-Forest)…

[111] There is a *proviso* in paragraph 4.4(b)(i) which, in effect, limits the Noteholder Class Action Claims that are preserved against the Third Party Defendants to $150 million.

[112] The Litigation Trust Agreement, in the "Preliminary Statement" at p. 1, confirms that the Litigation Trust claims and the class action claims are two distinct claims, that the class action claims are not being transferred to the Litigation Trust and that Litigation Trust claims shall not be advanced in the class action:

> For greater certainty: (x) the claims being advanced or that are subsequently advanced in the Class Actions are not being transferred to the Litigation Trust; and (y) the claims transferred to the Litigation Trust shall not be advanced in the Class Actions.

[113] In the event of any conflict between the Plan and the Litigation Trust Agreement, the Plan prevails.

[114] The amended statement of claim in this action alleges that through a combination of activities ranging from sloppy record keeping and general mismanagement through to outright fraud and theft, Mr. Chan and members of Inside Management, and other Sino-Forest employees in Hong Kong and China, caused Sino-Forest to materially overstate the value of Sino-Forest's revenues and assets and concealed personal profits made by them as a result of their fraudulent activities. It is alleged that Mr. Chan and other members of Inside Management, among other things:

(a) had operational and de facto control over allegedly arm's-length purchasers of Sino-Forest's timber, known as authorized intermediaries (AIs) and the suppliers of that timber (Suppliers), which control was never disclosed to Sino-Forest, its auditors or its directors;

(b) knew that Sino-Forest's AI's and Suppliers were incapable of performing the obligations required of them by their contracts;

(c) withheld and hid information from Sino-Forest's auditors;

(d) caused Sino-Forest to significantly overpay for assets sold by companies Mr. Chan secretly controlled;

(e) prepared certified and/or published false or materially misleading financial statements and public disclosure documents;

(f) concealed their unlawful activities from Sino-Forest through the use of personal non-company email accounts and by issuing instructions to hide transactions from the Sino-Forest accounting department;

(g) forged Sino-Forest contracts to evade restrictions imposed by Chinese regulators;

(h) entered into transactions that evidenced a circular flow of funds which lacked any commercial or business purpose;

(i) caused monies to be paid out by Sino-Forest and/or its subsidiaries for no proper purpose; and

(j) prepared and/or published false information in connection with certain debt or equity issues.

[115] The claim pleads that by controlling the Suppliers, AI's and other nominee companies, Mr. Chan and Inside Management carried out transactions which either overstated the economic substance of the transactions or were entirely fictitious.

[116] The claim also pleads that Mr. Chan personally profited from these insider relationships with the related party Suppliers, AI's and other nominee companies.

[117] The claim goes on to allege, in general, that Mr. Chan and Inside Management caused Sino-Forest to enter into a number of transactions that were fraudulent and/or devoid of any legitimate business purpose.

[118] The claim pleads that Mr. Chan and Inside Management perpetrated a massive fraud through the papering of hundreds of fictitious transactions. Much of the claim is then devoted to particularizing a list of some 17 types of transactions that are alleged to have been fraudulent.

[119] Also of importance to the defendant's argument on this issue is para 226 of the amended statement of claim, under the heading "Damages," which provides:

> Between 2007 and 2010, Sino-Forest raised in excess of $2.1 billion and CAD$800 million in Canada's debt and capital markets. The monies raised were cash held by Sino-Forest. Based upon Chan's fraudulent misrepresentations and conduct described above, this cash was spent on Sino-Forest's business operations. Sino-Forest believed it was using this money to buy trees, not to facilitate a fraud. Even where amounts were "legitimately" expended, such as for example, the leasehold

> costs for office space, such amounts were expended with the reasonable expectation that they were to be used as offices for a legitimate enterprise, not a fraud that only served to enrich Chan and his cabal. Sino-Forest had in excess of $3 billion in cash and it lost every penny "investing" in Chan's fictitious and fraudulent business model. Chan is liable for the full amount of these damages, further particulars of which will be provided prior to trial.

[120] The class action defines members of the class as persons who acquired Sino-Forest securities (defined as common shares, notes and other securities) from 2007 to 2011. The class action claim, in essence, is that Sino-Forest's publicly disclosed annual reports and financial statements, prospectuses and offering memoranda contained material misrepresentations which induced the class members to purchase and hold Sino-Forest securities. The misrepresentation allegations stem, in large measure, from the failure to disclose much of the same information that is pleaded as the acts of fraud alleged against Mr. Chan in the Borrelli action. The damages claimed are the amount of the capital raised by the various debt and equity issues that took place between 2007 and 2011.

[121] Specifically, the defendant argues that the class action claim asserts that Sino-Forest held itself out as a legitimate business operating in the commercial forestry industry in the PRC and elsewhere. It also asserts that Mr. Chan used Sino-Forest's "illusory success" to justify his lavish salaries, bonuses and other perks. The allegations in the class action include:

(a) the disclosure documents failed to disclose that from its very founding, Sino-Forest was a fraud and its assets were grossly overstated (paras. 98-104);

(b) Sino-Forest fraudulently overstated its forestry assets, in particular those assets in Yunnan, Suriname, and Jiangxi (paras. 105-121);

(c) Sino-Forest knowingly failed to disclose related party transactions including that Yuda Wood and its Suppliers were related parties (paras. 124-142);

(d) misrepresentations relating to Sino-Forest's relations with forestry bureaus and its purported title to forestry assets in the PRC – including payments to officials to obtain forestry bureau confirmations, that Sino-Forest possessed Plantation Rights Certificates and that Sino-Forest relied upon BVI contracts to demonstrate its ownership of standing timber which under PRC laws are void and unenforceable (paras. 143-157);

(e) Sino-Forest knowingly misrepresented that Sino-Forest's AIs were not related parties, misrepresented the tax related risks arising from Sino-Forest's use of AIs and that Sino-Forest's profit margins with AIs were legitimate (paras. 143-172);

(f) Sino-Forest materially overstated its cash flow statements and in particular overstated the purchase of timber assets (paras. 177-183);

(g) Sino-Forest failed to disclose that no proceeds were paid to it by its AIs (paras. 187-188); and

(h) Mr. Chan's (and the other defendants') conduct was oppressive to the security holders who had a reasonable and legitimate expectation that Mr. Chan would use his powers to direct the company in Sino-Forest's best interests and not contrary to Sino-Forest's Code of Business Conduct (paras. 274-277).

[122] Thus, the defendant argues, a) the same or similar facts as those pleaded in the Litigation Trust action give rise to the allegations of misrepresentation by the class action plaintiff's, and b) the Litigation Trust and the class-action plaintiffs seek the same damages, i.e., the amount of money raised by Sino-Forest in the capital markets.

[123] The defendant that argues the "bargain" struck when the Plan was approved was that Sino-Forest would be released of all claims in exchange for a transfer of its assets to Emerald and the assignment of its claims to the Litigation Trust. The assignment of Sino-Forest's claims, however, did not include claims made in the class action. Further, the Litigation Trust Agreement, by providing that the class action claims were not being transferred to the Litigation Trust, was an agreement that the class action claims were "excluded litigation trust claims." By structuring its claim as a claim for misrepresentation giving rise to damages measured by the amount Sino-Forest raised on the capital markets, the Litigation Trust claim is duplicative of the class action. This offends p.1 of the Litigation Trust Agreement because the Litigation Trust cannot make a claim that is made in the class action; it offends section 4.4(b) of the Plan because the Litigation Trust claims "limit or restrict" the class action claims. The Litigation Trust claim is said to limit or restrict the class action claim because of the principle against double recovery. The Litigation Trust and the class action plaintiffs have sued for the same pot of money – the amount Sino-Forest raised through its debt and equity issues. If such an award were made to the Litigation Trust in this case, it could not be made again in the class action. That would be a limitation or restriction on the class action claim.

[124] The defendant argues that because this action is precluded by the terms of the Litigation Trust Agreement and the Plan, the action must be dismissed.

Analysis

[125] The Plan asserts as one of its fundamental purposes to allow creditors and noteholder class action claimants "to benefit from contingent value that may be derived from litigation claims to be advanced by the Litigation Trustee." The Plan contemplates claims by the Litigation Trust for the benefit of creditors and noteholders.

[126] By the same token, the Plan preserves claims against third party defendants (which includes Mr. Chan) by the class action claimants. The Plan acknowledges that there are causes of action that belong only to the Litigation Trustee and causes of action that belong only to the class action claimants.

[127] The claims transferred to the Litigation Trustee are the claims *of Sino-Forest* for wrongs done *to Sino-Forest*. The claims in the class action are claims of investors and lenders who allege they were induced to acquire shares or advance loans by the fraudulent misrepresentations of Sino-Forest through its management. The class action, therefore, alleges wrongs done to the individual shareholder or noteholder.

[128] Importantly, and entirely consistent with the provisions of the Plan described above, nothing in the Plan released Mr. Chan and the other identified third party defendants from claims by Sino-Forest. Similarly, the Plan did not release Mr. Chan and the other identified third party defendants from claims in the class action (albeit only to a maximum limit of $150 million).

[129] It is a fundamental principle of corporate law that individual shareholders (and debtholders) have no cause of action in law for any wrongs done to the corporation. If an action is to be brought in respect of such losses, it must be brought either by the corporation itself or by way of derivative action: *Hercules Management Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, at para 59; *Livent Inc. v. Deloitte & Touche LLP*, 2014 ONSC 2176, at paras. 355-365; *Foss v. Harbottle*, (1843), 67 ER 189. Shareholders cannot raise individual claims in respect of a wrong done to the corporation. Where, however, a separate and distinct claim, such as the tort of fraudulent or negligent misrepresentation, can be raised with respect to a wrong done to a shareholder *qua* individual, a personal action may well lie.

[130] A fair and comprehensive reading of the class action claim (Exhibit 68) leads me to the conclusion that it is a securities class action alleging wrongs done to the individual shareholders and noteholders. The misrepresentations (false and negligent) alleged are representations to the individual shareholder or noteholder. The damage is said to be that, in reliance on the false representations made in public disclosure documents approved by management and issued by Sino-Forest, the shareholders and noteholders advanced funds to Sino-Forest which they otherwise would not have advanced. The false nature of the representations was eventually discovered, rendering Sino-Forest unable to repay its debts and Sino-Forest's shares valueless.

[131] By contrast, the Litigation Trust claim is a claim *by Sino-Forest* for wrongs done and breaches of duty owed specifically by Mr. Chan *to the corporation*. Only Sino-Forest could assert those claims absent leave to commence a derivative action, which has never been done.

[132] The claims of the plaintiff's in the two proceedings are, in my view, distinct and not duplicative. They involve different parties asserting different claims founded on analytically distinct theories of liability. The Plan contemplated these two proceedings and is structured (along with the Litigation Trust Agreement) accordingly. In my view, therefore, the Litigation Trust claim against Mr. Chan is not, in the language of the Litigation Trust Agreement, "a claim being advanced in the class action." The Litigation Trust claim does not, in the language of section 4.4 (b) of the Plan, "limit or restrict" the class action in any way.

[133] It appears to me that the defendant has confused the issue of who has the right to assert which "claims" under the governing agreements and court orders with the issues of the underlying

factual matrix (that is, the acts or conduct constituting the alleged false misrepresentations or fraud) and how damages arising from those claims are calculated.

[134] The fact that specific acts or conduct of, say, Mr. Chan may invoke liability to different plaintiffs based on different breaches of duty or theories of liability does not mean the claims are the same or are necessarily duplicative. Likewise, the fact that the Litigation Trust has chosen to calculate its damages as the loss to the corporation of the benefit of the money it raised in the capital markets does not make its "claim," based on alleged breaches of duty owed to the corporation, the same as the claim in the class action. It is true that the class action claimants seek damages calculated as a subset of those same capital raises. The loss to those claimants, however, is said to be the money they individually advanced to Sino-Forest on the basis of the allegedly false representations. The loss to the corporation is that money available to it to conduct its legitimate businesses (regardless of where the money came from) was dissipated in the pursuit of a fraudulent scheme to enrich Mr. Chan and other members of Inside Management, to the detriment of the corporation and in breach of Mr. Chan's duties to it.

[135] The trial in this action has been concluded. The class action, I am advised, has not progressed beyond the pleadings stage. To the extent a court, in the future, concludes that a dollar of recovery in the Litigation Trust action is recovery of the same dollar sought in the class action, this seems to me to be a problem of double recovery, which ought to be dealt with if and when it actually arises.

[136] The Supreme Court of Canada addressed the issue of the potential for double recovery in *Pro-Sys Consultants Limited v. Microsoft Corporation*, 2013 SCC 57, [2013] 3 S.C.R. 477, at para. 39. Citing *Multiple Access Limited v. McCutcheon*, [1982] 2 S.C.R. 161, the court said that "courts are well able to prevent double recovery in the theoretical and unlikely event of plaintiffs trying to obtain the same relief twice." There are a number of judicial "tools" available to prevent double recovery. The court, however, adopted with approval the statement of Donald J.A. of the British Columbia Court of Appeal, dissenting in *Sun-Rype Products Ltd. v. Archer Daniels Midland Co.*, 2011 BCCA 187, 331 D.L.R. (4th) 631, at para. 30, to the effect that the double recovery rule "should not in the abstract bar a claim in real-life cases where double recovery can be avoided."

[137] There has been no evidence in this trial to suggest that a future court dealing with the class proceedings or for that matter, the distribution of funds from the Litigation Trust (were it to be successful in this action and make recovery), could not preclude double or multiple recovery of claims to the same funds.

[138] I agree with the plaintiff that the effect of the defendant's argument on this point is not to preclude him being found liable twice for the same thing but to preclude him from being found liable at all.

[139] Even if I were wrong in my conclusion on this issue, the appropriate remedy would not be to dismiss the plaintiff's action. I say this because of the *proviso* in section 4.4(b)(i) of the Plan,

which limits the class action claim "carve out" from the general release to $150 million. In the Litigation Trust action, damages are sought in the amount of $2.6 billion. At most, therefore, the class action would prevail only to the extent of $150 million. The relationship of potentially competing damage awards between the Litigation Trust and the class action and the distribution of any recovery, in the event these claims are successful, is again a matter best left for resolution if and when a problem arises. Competing claims to the first $150 million of recovery would not, however, constitute a bar to the Litigation Trust action in its entirety.

Affirmation

[140] The defendant argues that Sino-Forest affirmed all the contracts with Suppliers and AIs which the Litigation Trust now claims, as against Mr. Chan, were fraudulent. The defendant argues that the contract law principle of affirmation prohibits a party from affirming a contract and later taking the position that the contract was fraudulent so as to make a claim for damages for that fraud. The argument goes as follows.

[141] The defendant argues that Sino-Forest affirmed all of the contracts with Sino-Forest's subsidiaries, whether loan agreements between Sino-Forest and the subsidiaries, or the operating contracts that the subsidiaries had with third party suppliers (such as Suppliers and AIs). All of the contracts, including the standing timber contracts, the WFOE contracts, the wood log trading contracts, and the alleged suspicious transactions were affirmed by Sino-Forest when it conveyed those contracts, as assets, to EPHL and then EPGL under the Plan.

[142] After the Plan Implementation Date, EPGL had the exclusive right to enforce all contracts of Sino-Forest subsidiaries. The noteholders negotiated and agreed to the division of the Sino-Forest assets. They are commercially sophisticated parties who wanted the benefit of the assets held by the Sino-Forest subsidiaries, including the contracts those subsidiaries entered into and the loans that they received from Sino-Forest. EPGL took steps to recover under the contracts - the Xunxiang contract is an example where EPGL pursued and won an arbitration award for damages under a Sino-Forest subsidiary trading contract. EPGL would not have been entitled to pursue that claim had all of the rights to those agreements not been transferred to it free and clear.

[143] EPHL and EPGL subsequently conveyed the assets of EPGL through two transactions – the sale of Greenheart in 2015 to Newforest and the sale of the EPGL shares (the company that holds all of the contracts claimed by the plaintiff to be fraudulent) to New Plantations. As part of the sale of the shares of EPGL, the noteholders entered into the RAPA to monetize these contracts and to share in the proceeds. EPHL's CEO, James Dubow, represented to the shareholders of EPHL that there would be a recovery under the RAPA, but just not within the near term.

[144] The defendant argues that Sino-Forest, having transferred these contracts free and clear to EPHL and EPGL for fair value, has affirmed the contracts. The contracts were further affirmed when EPGL and EPHL transferred these contracts to Newforest and New Plantations, again for valuable consideration.

[145] Thus, the defendant argues that the repeated affirmation of the loan agreements and the contracts of the Sino-Forest subsidiaries at issue in this litigation results in the Litigation Trust being barred from seeking damages from Mr. Chan on the allegation that the contracts were entered into by fraud and/or false representation.

Analysis

[146] The principle of affirmation is one of long-standing. In *Brown v. West*, 1846 CarswellOnt 2, 1 E. & A. 117, the Upper Canada Court of Error and Appeal dealt with a case where a party acquired property, learned of a fraud in the transaction, but nevertheless held onto the property and leased it to another. The court rejected his action for rescission based on the fraud. The court said (at page 9):

> We could not possibly hold that there is no consideration for the note which he has given, while he thus retains the possession of his purchase, and has done so for more than two years, receiving rent from a tenant, to whom he has made a lease since his knowledge of the alleged fraud.

[147] The Court cited *Campbell v. Fleming*, 1 Ad. & Ell. 40, where Parke J. said:

> After the plaintiff knowing of the fraud, had elected to treat the transaction as a contract, he lost his right of rescinding it.

[148] The Court also cited the reasons of Patterson J. in the same case, who wrote:

> In this case the plaintiff has paid the money and he now demands it back on the ground of the money having been paid on a void transaction; to entitle him to do so, he should at the time of discovering the fraud have elected to repudiate the whole transaction. Instead of doing so, he deals with that for which he now says he never legally contracted.

To similar effect is *Betrand v. Racicot*, [1979] 1 S.C.R. 441, and *McCarthy v. Kenny*, [1939] 3 D.L.R. 556, at paras. 41-43, 49-50 and 65-66.

[149] The defendant says the plaintiff is trying to do in this case what the courts have said cannot be done. Sino-Forest has conveyed its rights to all of the contracts for fair value as part of the Plan; yet these are the same contracts which the plaintiff now alleges in this action were fraudulent.

[150] The defendant urges upon me that I should not permit a situation where the plaintiff is allowed to sue Mr. Chan on the basis that he caused Sino-Forest to enter into a series of fraudulent contracts, when Sino-Forest has, at the same time, assigned those contracts for fair value to EPHL. EPHL and EPGL have further complicated the problem by re-assigning these contracts to Newforest and New Plantations, and entering into the RAPA, which provides for recovery to

EPHL and EPGL in the event New Plantations is able to successfully realize on these allegedly "fraudulent" contracts.

[151] I am unable to agree that the principle of affirmation has any application to the circumstances of this case. There are several reasons for this.

[152] First, the Litigation Trustee is not suing Sino-Forest's subsidiaries or their counterparties (Suppliers and AIs) in various timber contracts with those subsidiaries. Sino-Forest Corporation was not a party to those contracts. Sino-Forest is suing its fiduciary, Mr. Chan, for fraud, breach of fiduciary duty and negligence. At its core, the claim is that Mr. Chan and other members of Inside Management caused Sino-Forest subsidiaries to enter into fraudulent contracts with related parties in order to deceitfully inflate the value of Sino-Forest and divert funds acquired by virtue of that inflated value away from Sino-Forest to themselves.

[153] Neither Sino-Forest nor the Litigation Trust were ever in the position of having to make an "election." They are not asserting and have never asserted claims of a contractual nature against Mr. Chan. The principle of affirmation means, effectively, that after a contract is affirmed, it cannot be rescinded, *McCarthy, supra*, at paras. 65-66. In connection with the Litigation Trust's claims against Mr. Chan, the only contract to affirm or rescind was the employment contract, which is largely irrelevant to these proceedings.

[154] The defendant tries to argue that the transfer of Sino-Forest's assets to its creditors under the CCAA Plan is analogous to Sino-Forest's affirmation (in the sense used in the cases of an "election" to sue for rescission or to affirm the contract) of all third-party contracts with all of the subsidiaries that were transferred under the Plan.

[155] I cannot agree with that submission. No evidence or law was cited to support this proposition. It is entirely illogical on its face. Sino-Forest was not a party to those contracts. The affirmation/rescission choice was for the subsidiaries, as the contracting party, to make, not Sino-Forest.

[156] Similarly, I am unable to accept that suing Mr. Chan for fraud and breach of fiduciary duties he owed to Sino-Forest is analogous to one of the subsidiaries suing a Supplier or AI for rescission of a timber contract. The two are factually, legally and analytically distinct.

[157] Finally, even if the analogies advanced by the defendant were apt, the law is clear that the principle of affirmation merely precludes an action to *rescind* an affirmed contract; it does not preclude an action for damages for fraud, *McCarthy, supra*, at paras. 65-66.

[158] For these reasons, I conclude that the plaintiff's action is not barred by the principle of affirmation.

Standard of Proof

[159] I agree with the defendant that the plaintiff's case is largely one of circumstantial evidence, which requires inferences to be drawn. This is because (unlike direct evidence, where the only issue is whether the trier of fact accepts the evidence as true) there is an "inferential gap" between the facts proved and the facts sought to be inferred. There is nothing wrong with circumstantial evidence. It is perfectly admissible, but the inference drawing process is conceptually different and that difference must be recognized.

[160] Permissible inferences can only be based upon proven facts. Even then, only inferences which logically and reasonably flow from proven facts are permissible inferences. An inference which does not proceed logically and reasonably from proven facts is speculation.

[161] The line between a reasonable inference and impermissible speculation is drawn by the laws of logic. If there is logical probability that an inferred fact follows from proven evidence, the trier of fact is given the opportunity to draw the conclusion. If there is a reasonable probability that the conclusion flows from the proven fact, the inference may be drawn.

[162] Ultimately, however, the court must act on such a preponderance of evidence as to show whether the conclusion the plaintiff seeks to establish is substantially the most probable of the possible views of the facts, *Clarke v. The King*, (1921) 61 S.C.R. 608 at para. 34.

[163] The defendant suggests that a higher onus exists in cases involving allegations of fraud. I do not agree. As I discussed in *Indcondo Building Corporation v. Sloan*, 2014 ONSC 4018, 121 O.R. (3d) 160, at para. 59, the Supreme Court of Canada decision in *C. (R.) v. McDougall*, [2008] 3 S.C.R. 41 established that in civil matters there is only one standard of proof. Although some cases involve more serious consequences by virtue of the nature of the allegations made in them, the seriousness of the allegations does not alter the standard of proof in civil cases. There is only one standard of proof in all civil cases and that standard is 'proof on a balance of probabilities.'

Document Translation

[164] I will also say a word about document translations. Many of the documents filed in the trial proceedings are in Chinese. The plaintiff had every document on which it specifically intended to rely at trial translated into English by professional translators. These translations were proved by way of affidavit.

[165] In the course of hearing pretrial motions, I dealt with a specific problem that arose in the translation of a controversial document which the plaintiff has called the 'nominee companies caretaker list'. As I said in my February 27, 2017 ruling on this matter, translation from one language to another is a question of expertise. In that particular instance, I ruled that a solicitor acting for one of the parties could not be regarded as having the necessary independence to perform the role of an expert on any matter of controversy. Since the translation of what I have styled the Nominee Company Managers List was a matter of controversy, I held that the solicitor's translation could not be relied upon in evidence. As a result, the plaintiff retained an

independent translator and her translation was put in evidence, again by way of affidavit, without objection or any responding evidence from the defendant.

[166] It transpired during the trial from time to time that the defendant and some of the defendant's witnesses took issue with the plaintiff's professional translation of a document, and proferred their own view of what the translation should be.

[167] The defendant had all of the translated documents months before trial. If there were material disagreements about the accuracy of the professional translations obtained by the plaintiff, they ought to have been raised and, if necessary, addressed by the filing of competing expert translation evidence.

[168] I did not exclude the witness's evidence on translation matters but it must be remembered that the defendant, as well as most of his witnesses, has a keen, personal interest in the outcome of these proceedings. They can in no way be regarded as independent. Several of the defendant's witnesses are defendants in parallel proceedings in the Hong Kong court or otherwise implicated in the alleged frauds. Further, apart from Mr. Ho, they all felt the need to testify with the assistance of Mandarin or Cantonese interpreters. Thus, their qualifications to comment on the validity of document translations from Chinese to English must be questioned.

[169] An example involving the evidence of Zeng exemplifies the problem. The plaintiff relies on correspondence concerning the establishment and management of "peripheral companies." Zeng deposed in his examination in chief that the words "peripheral companies" used in these documents should be translated as "outside companies." On cross-examination, Zeng admitted that this variation in the proposed translation originated, in fact, not from his own knowledge of English translation from Chinese characters but from Mr. Chan's Hong Kong lawyer, Mr. Tsang, who helped draft Zeng's prefiled evidence.

[170] Whenever a witness' translation of a document differs from that of the professional interpretation, I prefer the professional translation, in the absence of any competing professional translation from the defendant.

Issues

[171] There are two broad issues of liability in this case:

1) whether Mr. Chan perpetuated a fraud against Sino-Forest; and

2) whether Mr. Chan breached fiduciary duties owed to Sino-Forest.

[172] The plaintiff pleaded a cause of action against Mr. Chan in negligence as well. However, the case was not seriously advanced on the basis of negligence. No expert testimony was offered on the standard of care of a corporate officer and director in Mr. Chan's position. The record is insufficient to decide this case on the basis of the claim in negligence and, in light of my conclusions regarding fraud and breach of fiduciary duty, it is unnecessary to do so.

[173] The tort of civil fraud has four elements:

(i) the defendant made a false representation;

(ii) the defendant had some level of knowledge of the falsehood of the representation;

(iii) the false representation caused the plaintiff to act; and

(iv) the plaintiff's actions resulted in a loss.

[174] As for a breach of fiduciary duty, it must be shown that:

(i) Mr. Chan owed fiduciary duties to Sino-Forest;

(ii) Mr. Chan breached those fiduciary duties.

[175] The plaintiff's allegations of breach of fiduciary duty are largely based on the same factual underpinnings as the allegations of fraud. In short, the plaintiff alleges that Mr. Chan had an undisclosed interest in many significant Sino-Forest transactions; that Mr. Chan preferred his own interest to the interest of Sino-Forest; and that Mr. Chan had undisclosed conflicts of interest that permeated his tenure as chairman and CEO.

[176] Lying beneath these two general issues are two critical factual disputes which are at the heart of this case.

[177] The first critical disputed issue involves whether Sino-Forest's counter-parties in the BVI standing timber transactions, WFOE standing timber transactions and wood log trading transactions were *bona fide* arm's length parties or whether they were secretly connected to and under the control of Mr. Chan (or other members of Inside Management at Mr. Chan's direction).

[178] The second critical disputed issue is whether the BVI and WFOE standing timber transactions which purported to produce an asset value in 2011 of $2.99 billion:

a) were real transactions for which valuable consideration was paid and received;

b) resulted in BVI standing timber assets that could be located and were actually owned by Sino-Forest's subsidiaries and could be harvested or sold on the market for valuable consideration; and

c) had a value anywhere near $2.99 billion.

[179] I will address these issues first with a general analysis of the issue of credibility, the inferences to be drawn from the use of non-Sino-Forest email servers by senior managers and others, and the allegation that Mr. Chan controlled non-Sino-Forest corporations through a

complex system of nominee shareholders and directors. I will then proceed to analyze the separate allegations of fraud and breach of fiduciary duty which were pursued at trial. They are:

1) the BVI standing timber fraud;
2) the WFOE standing timber fraud;
3) the wood log cash gap trading fraud;
4) the wood log deposit fraud;
5) March Maple; and
6) Greenheart.

Credibility

[180] The central disputed issues of fact in this case involve inferences to be drawn from several hundred emails and other contemporaneous documents unearthed by the Litigation Trustee during his forensic examination, when considered in the context of all of the other evidence and the surrounding circumstances.

[181] The plaintiff argues that the inferences to be drawn are that Mr. Chan and Inside Management perpetuated a fraud. One of the main issues in the trial involved Mr. Chan's attempt to provide an explanation of the multitude of contemporaneous documents relied on by the plaintiff. His evidence, and that of his witnesses Yosanda Chiang, George Ho, Alfred Hung and John Zeng was largely an attempt to establish an evidentiary basis for a different, and equally logical and reasonable inference, that Mr. Chan and Inside Management were not involved in a fraud.

[182] It was in that context that the credibility of Mr. Chan and the other defence fact witnesses took on particular significance.

[183] In assessing credibility, the court may consider the integrity and intelligence of the witness, the witness's appearance of sincerity and truthfulness in the witness stand, whether the witness was candid, frank, forthright and responsive to questions asked or evasive or hesitant and whether the witness was biased or had a personal interest, or lack of personal interest in the outcome of the trial. The court may consider the witness's memory, the capacity to remember and the ability to describe clearly what was seen and heard, whether or not the witness has any particular reason to assist him in recalling the precise event and what was said and whether or not there were inconsistencies in the witness's testimony at trial or in what the witness said at trial and on a prior occasion under oath or otherwise. A series of inconsistencies may cause the trier of fact to doubt the reliability of the evidence.

[184] Where oral testimony conflicts with reliable documentary evidence, the documentary evidence may appropriately be preferred. In *Bradshaw v. Stenner*, 2010 BCSC 152, [2010] B.C.J. No. 1953, at para. 188, the B.C. Supreme Court said:

> Most helpful in this case has been the documents created at the time of events, particularly the statements of adjustments. These provide the most accurate reflection of what occurred, rather than memories that have aged with the passage of time, hardened through this litigation, or been reconstructed.

[185] Thus, one must subject a witness' testimony to an examination of its consistency with probabilities that surround other evidence. Does it match with other proven or undisputed facts of the case? Documents created at the time of events are very helpful as they can provide the most accurate reflection of what occurred, rather than memories that have aged with the passage of time, harden through litigation or been reconstructed. The inability to produce relevant documents to support one's case is also a relevant factor that negatively affects credibility.

[186] One of the leading authorities on evaluating witness credibility is *Faryna v. Chorny*, [1951] B.C.J. No. 152 (B.C.C.A). The B.C. Court of Appeal confirmed at para. 10 that the test of witness credibility is essentially one of probabilities:

> The credibility of interested witnesses, particularly in cases of conflict of evidence, cannot be gauged solely by the test of whether the personal demeanour of the particular witness carried conviction of the truth. The test must reasonably subject his story to an examination of its consistency with the probabilities that surround the currently existing conditions. In short, the real test of the truth of the story of a witness in such a case must be its harmony with the preponderance of the probabilities which a practical and informed person would readily recognize as reasonable in that place and in those conditions.

[187] The assessment of the credibility of a witness is "more of an art than science," and cannot be reduced to a set of rules. However, the following questions may appropriately be considered as a guide:

- Whether the witness's evidence is internally consistent, logical and plausible. In other words, does it "make sense"?

- Whether there is independent evidence that corroborates or contradicts the witness' testimony? The absence of such evidence may also be significant.

- Whether the witness changes his or her evidence during direct and cross-examination, or between examination for discovery and trial, or is otherwise inconsistent in recalling events?

- Whether the witness exhibits sincerity and candour, or is biased, reticent and evasive? Demeanour, alone, however, cannot be determinative of credibility. Indeed, demeanour alone is now well-recognized as a particularly unhelpful indicator of credibility.

[188] Applying these principle to the facts of this case, I have drawn the following conclusions:

- Mr. Chan and his other fact witnesses are not disinterested parties. Nearly all are implicated as co-conspirators in Mr. Chan’s fraud. Even those that are not being actively sued by the Litigation Trust in parallel proceedings other jurisdictions would logically be concerned about their reputations or participation in the events giving rise to this litigation.

- Mr. Borrelli of course, as plaintiff (albeit in a representative capacity), also has an obvious interest in the litigation.

- Mr. Chan and his witnesses were keenly aware of which issues were contentious, and became noticeably more combative and evasive when testifying about these issues. Mr. Chan had a particular propensity for avoiding answers to difficult questions by offering his speculations on the motives or conduct of others, claiming he had no knowledge and quibbling over translation matters.

- Also, despite being provided in advance of his cross-examination with specific notice of the many documents ultimately put to him, Mr. Chan often avoided answering questions about these documents by saying he would need to investigate matters further.

- I found the evidence of Mr. Chan, and his other fact witnesses, to be contrived. Mr. Chan and his fact witnesses appeared to adopt similar strategies for explaining away problematic documents. Several of the same approaches were adopted throughout their testimony. Their evidence changed in response to new evidence or when confronted with inconsistencies or other problems with their account of events.

- They were often evasive, and often retreated into quibbling about translation or different possible meanings that were usually immaterial. They also often blamed subordinates for being obviously “wrong” or not understanding what they were talking about.

- Their explanations were frequently implausible on their face, lacking any ring of truth, and/or unsupported by any contemporaneous documentary evidence.

- Mr. Chan's evidence, in particular, was frequently impeached by prior inconsistent testimony given under oath on discovery or in affidavits sworn in earlier proceedings in this case.

- Frequently, inculpatory contemporaneous communications were dismissed as "proposals" when nothing about them is suggestive of a proposal and where other documents made it clear they were more than "proposals".

- The defence witnesses also frequently tried to explain away an unexpectedly close relationship between supposedly arms' length parties that seemed improper or, at least, highly suspicious, by saying they were "doing a favour" for a friend or by invoking Chinese law or custom such as guanxi (the role of trust and mutually beneficial relationships in business dealings) or by simply saying, "that's how we do things in China."

- Most of all, however, looming over the testimony of Mr. Chan, Yosanda, Ho, Zeng and Hung, in particular, is the sheer, flat out inconsistency of their interpretations of contemporaneous documents with the plain meaning of the content of those documents and the improbability of their explanations.

[189] The plaintiff's witnesses were largely professional people. Hyde, Engen, Maradin, Henderson, Brough and Dubow were all personally involved at various stages of Sino-Forest's operations and collapse. They have no interest in the outcome of these proceedings, however, and little incentive to lie, misrepresent or tailor their evidence.

[190] Mr. Borrelli was not personally involved in relevant events until after the CCAA Plan. His forensic skills were brought to bear in the analysis and organization of the documents. As plaintiff, he is of course directly interested in the outcome of these proceedings. Mr. Borrelli draws many inferences based on his forensic analysis of documents, financial records and other evidence. But, as I said in an earlier ruling on an admissibility motion, inferences are for the Court, not for the plaintiff, to draw. I have, therefore, treated all suggestions of inference by the plaintiff, not as evidence, but as nothing more than the expression of an inference he would respectfully ask the Court to draw based on the facts as I find them to be.

[191] In any event, the inferences that matter in this case are those which arise, not from Mr. Borrelli himself, but from the contemporaneous documents introduced at trial, viewed in the context of all the other evidence as a whole. It was these inferences that were the focal point of counsel for both sides during the trial and in their arguments. And it is these inferences to which I will turn in the succeeding sections of these Reasons.

Use of Non-Sino-Forest Email Accounts

[192] One category of circumstantial evidence from which the plaintiff invites the court to draw the inference of fraudulent activity involves the use of non-Sino-Forest email addresses. That

non-Sino-Forest email addresses were used, and in some cases instructed to be used, by senior Sino-Forest employees is not in doubt. The controversy between the parties is over what, if anything, can be inferred from the use of non-Sino-Forest email addresses by senior Sino-Forest employees. This largely turns on an analysis of the content of the emails themselves and of the explanations for the use of non-Sino-Forest email addresses advanced by the defendant and the defendant's witnesses during the trial, in the context of the evidence as a whole.

[193] In essence, the plaintiff argues that the use of non-Sino-Forest email addresses is evidence of consciousness of guilt; that the use of non-Sino-Forest email addresses to conduct business was done in order to conceal the communications (and related activity) from discovery by non-insiders, professional advisors and the like. Mistakes were made: some of these emails slipped through and were later found by the IC advisors and the plaintiff through exhaustive examination of Sino-Forest's electronic records.

[194] The defendant and his witnesses, most of whom were Inside Management at Sino-Forest, used non-Sino-Forest email addresses for certain activities from time to time. They argue that these non-Sino-Forest platforms were used to overcome server problems which interfered with their ability to communicate while they were travelling in mainland China.

[195] The defendant argues, as well, that the so-called perpetrators of this alleged attempt at concealment must have been incredibly inept at executing their plan because so many of these non-Sino-Forest emails did, in fact, surface on Sino-Forest computers, or were distributed to addressees who included at least one Sino-Forest email address. The defendant argues that the use of personal email addresses for business, in addition to the employer's email address, is common and does not constitute any evidence from which an implication of wrongdoing or culpability can reasonably be inferred.

[196] The issue comes up in many different contexts. A theme that emerges, however, from an analysis of these emails is that Sino-Forest personnel were directed to use non-Sino-Forest email accounts when discussing certain subjects which were regarded as particularly sensitive at the time.

[197] An example of this can be found in an email thread dated July 9 and 10, 2011, a month after the Muddy Waters Report was released, just as the IC investigation was getting underway. Ho emailed Alan Cheung (who worked under Ip) using his Sino-Forest email regarding an inquiry from PwC, which was one of the IC Advisors. Mr. Chan, Ip, and Xu Ni were copied on the email thread. In responding to Ho's inquiry, Cheung said: "Hi George, think it not prudent using this mail platform. Please see reply in your other mail box."

[198] On its face, the email is innocuous enough. It raises a question, however, about why Cheung would say it was not prudent to use the Sino-Forest email platform and why he would tell Ho to look at the more detailed answers to Ho's questions in Ho's "other mail box."

[199] This email also highlights another problem arising out of the use of non-Sino-Forest email addresses. By definition, communications to non-Sino-Forest email addresses would not normally show up on the Sino-Forest server unless they included a Sino-Forest address or were copied or saved to a file on Sino-Forest's computers or servers. Given the allegations in the statement of claim and the allegations made in Mr. Borrelli's evidence, the issue of senior management's use of non-Sino-Forest email addresses was clearly in play. Mr. Chan has not produced any electronic communications involving non-Sino-Forest email addresses. Indeed, Mr. Chan has produced almost no documents at all in this proceeding. None of the other defence witnesses, who were parties to most of these communications, have produced or come forward with any other communications involving non-Sino-Forest email addresses either.

[200] If these documents exist on other servers (which is admitted, and is, in any event, proven on the evidence), it is reasonable to infer that they would have been produced if they established that nothing untoward was afoot or that there were perfectly legitimate or innocuous reasons for conducting these communications off the Sino-Forest servers. None, however, have been produced. It is, therefore, purely by chance that Sino-Forest has any of these emails at all.

Peripheral Companies/haidao2.com

[201] Another sensitive subject in respect of which Sino-Forest employees were directed to use a non-Sino-Forest email domain involved communications about "peripheral companies."

[202] In March 2010, Yu Wen, a Sino-Forest employee, circulated to a group of other Sino-Forest employees an email which told the recipients that, at the direction of Yeung, email addresses with the suffix "haidao2.com" had been established for discussions regarding "peripheral companies." It said:

> In order to regulate management of the peripheral companies, pursuant to the recommendation of Vice President Simon Yeung, the peripheral companies' unified domain name "haidao2.com" email is now operational and may be activated immediately. In the future, please use these email addresses for any email correspondence concerning the peripheral companies.

[203] The English translation of "haidao" is pirate. The term "peripheral companies" is used in a number of communications and documents, which are discussed further below. The plaintiff alleges that these peripheral companies were in fact non-arm's length companies under the control of Mr. Chan with which Sino-Forest did business.

[204] Attached to Yu Wen's email was a list of the haidao2.com email addresses. The addresses were provided to specified Sino-Forest employees, including Ip, Yeung, and Ho, as well as non-Sino-Forest individuals also associated with the peripheral companies, including a former Sino-Forest employee and friend of Mr. Chan's, Huang Ran, who controlled Yuda Wood.

[205] Following Yu Wen's email, employees of Sino-Forest and the peripheral companies used haidao2.com and other non-Sino-Forest email address to communicate regarding the peripheral companies.

[206] On March 23, 2011, the haidao2.com email address was used to send an email to a Sino-Forest employee at a Sino-Forest email address stating: "[p]lease confirm receipt of the attachment. I am also sending the scanned files from the peripheral companies." Within an hour, Kathy Tian of Sino-Forest, who worked for Ho, sent an email to Huang Ran (at his haidao2.com email address), copying Ho and Ip (also at non-Sino-Forest email accounts), warning that Sino-Forest email accounts should not be used when discussing sensitive information that is not suitable to be disclosed to the public, such as peripheral companies:

> At the end of last year, Manager Liang Yong and Yang Jun communicated a few times, hoping to coordinate and remind employees from the peripheral companies to be careful when sending emails to Sino-Forest email addresses. We have the following recommendations, please consider and help coordinate:
>
> 1. If any information is not suitable to be disclosed to the public, do not directly email to any colleague's Sino-Forest email address;
>
> 2. In sending content to the Sino Forest mailbox, please avoid sensitive words;
>
> For instance, below there appeared the words such as "peripheral companies" again, and payment reminders from different companies have appeared in the same inbox. Please help coordinate. Thank you!

[207] Ho's explanation for this email during his cross-examination was that it documented "a normal squabble between the operating guy and our operations and as well as whoever is the outside company." I do not accept that explanation as at all credible. Ho's attempt to explain away the use of non-Sino-Forest emails is contrived and unresponsive to the core issue. The burden of the instruction is clear and explicit: Do not talk about peripheral companies on the Sino-Forest email platform! The topic of peripheral companies was, therefore, regarded as too sensitive a topic to be discussed on the company's server. The implication is clear. The use of peripheral companies was something not to be disclosed outside a select few using non-Sino-Forest emails. Discussion of the use of peripheral companies was not to take place on Sino-Forest servers to prevent disclosure or discovery of what was taking place. Instead, the "pirate" email account was set up for such discussions.

Project Russia / Eminens

[208] Mr. Chan's sister, Pauline Chan (Pauline), had a company called Eminens. Similar to the "haidao2.com" email accounts for discussions regarding peripheral companies, certain employees of Sino-Forest and its counterparties were provided with Eminens email accounts and a File Transfer Protocol ("FTP") database to use for certain projects, including Project Sugar and Project Russia. Both those projects related to wood log trading deposits which the plaintiff alleges were

fraudulent. The Eminens servers were another mechanism by which discussions regarding certain "sensitive" subject matters, such as wood log trading involving Project Sugar and Project Russia, were kept hidden from anyone who might later be reviewing Sino-Forest's records.

[209] In August 2009, email addresses with the suffix "@task.eminens.org" were provided to Sino-Forest personnel including Hung, Ho, Christine Wong (Ho's assistant), Xu Ni, and Tang Bin (who worked under Xu Ni). The email stated that the "@task.eminens.org" email addresses would replace the email addresses ending in "@eminens.org." This clearly indicates that the individuals listed on the email already had email accounts ending in "@eminens.org."

[210] On September 23, 2009, Henry Chen (who worked under Xu Ni in Sino-Forest's legal department) sent an email from his Sino-Forest email address to Alex Lin (who worked under Ho) copying the Sino-Forest Project Russia email group. The email attached meeting minutes of certain discussions earlier that day. Ho, who was included in the Sino-Forest Project Russia email group, responded on September 24, 2009 stating "Guys, I believe you should use the other email address for these types of communication."

[211] On October 9, 2009, Christine Wong at Eminens emailed projectsugar.legal@task.eminens.org, projectsugar@eminens.org, and projectsugar.account@task.eminens.org, listing the individuals that would have access to each of those accounts. The users included Sino-Forest and non-Sino-Forest personnel. For example, the projectsugar@eminens.org was for "Senior Management" and included Ip, Hung, Ho, Xu Ni from Sino-Forest, as well as Pauline and Jack Chen ("Chen"), who worked at Eminens at the time.

[212] On January 27, 2010, Christine Wong, using her "@task.eminens.org" email address, sent an email with the subject line "Important! FTP: Task/Share-Russia" to a number of Sino-Forest employees at "@task.eminens.org" email addresses, although two individuals were emailed at Sino-Forest Group email addresses. The email stated "Effective immediately, pls use the FTP link below as our central database to upload and download data and documents relating to Russia project and Longjiang Commercial." After providing instructions on accessing the FTP database, she wrote "FYI, only the following people in our team have access to the FTP. Pls do not share the access with other people."

[213] Again, although subjects relevant to this litigation were clearly discussed using "eminens" email accounts and relevant documents were uploaded to the Eminens FTP, Mr. Chan admitted under cross-examination that he did not ask his sister Pauline for any of the documents on the Eminens servers and that none have ever been produced.

[214] A number of Mr. Chan's witnesses attempted to explain away the use of non-Sino-Forest email addresses by asserting that Sino-Forest email accounts did not function properly in the PRC and that Sino-Forest's servers were occasionally down. For example, Ho tried to explain his September 24, 2009 email in which he stated "Guys, I believe you should use the other email address for these types of communication" by speculating that:

> So in this case, I may have been under the – or travelling during, at that point in time. If I can't get hold of this e-mail, I just told them to get me other e-mail address, whatever works for them and works for me.

[215] Ho's explanation does not accord with the direction in his email to use other email addresses for certain "types" of communications. In fact, there is not one email directing the use of non-Sino-Forest emails which attributes the need to use non-Sino-Forest email addresses to problems with Sino-Forest's servers in mainland China. In every message in which the use of a non-Sino-Forest email platform is raised, Sino-Forest personnel were directed to use non-Sino-Forest email addresses in relation to certain specific subject matters, for example, where "information is not suitable to be disclosed to the public" or where "peripheral companies" were concerned.

[216] I find the explanations offered by the defence witnesses for the use of non-Sino-Forest emails incredible. The suggestion that it was necessitated by poor email service in mainland China is completely inconsistent with the plain, and explicit, language of the emails themselves. There is no independent corroboration of malfunctioning email servers in mainland China that interfered with the conduct of Sino-Forest's business. The use of non-Sino-Forest emails was restricted to a designated few for specific subject matters. The clear and stated purpose of non-Sino-Forest email addresses was to prevent disclosure of "sensitive" subjects on Sino-Forest's email servers.

[217] The emails are relevant to a matter in issue in this litigation. They were not produced, or even sought to be produced, by the defendant. There has been no explanation for this failure to produce relevant documents.

[218] As to the defendant's argument that the attempted "concealment" must have been incredibly inept, given the number of emails found by the IC and Mr. Borrelli, I would say two things. First, mistakes happen. Email use is notoriously fraught with slips and errors. Rigorous email policy enforcement, where large numbers of users and high traffic volumes are involved, is bound to be imperfect.

[219] Second, although there are quite a few emails using non-Sino-Forest servers that slipped through into the Sino-Forest electronic records, it is purely by chance, as noted earlier, that these were discovered at all. I say this because of the complete failure of the defendant or any of his witnesses to produce any documentary records from the non-Sino-Forest servers. As a result, we have no idea whether the "mistakes" that ended up on Sino-Forest computers and other communication devices represent a significant or an infinitesimal percentage of the email traffic that actually took place off of Sino-Forest's systems. It seems likely, given the scope of the activities involved, that what was found on Sino-Forest devices was a very small percentage of the concealed communications.

[220] In the circumstances, and in the context of other evidence dealt with in subsequent sections of these Reasons, I find the use of non-Sino-Forest emails was established in an attempt to conceal

certain activities from scrutiny. These activities included the establishment and use of peripheral companies. I find the peripheral companies were companies controlled by Mr. Chan and Inside Management that did business with Sino-Forest. The selective activities also included certain projects, such as Project Russian discussed below, whose purpose was to defraud Sino-Forest by diverting Sino-Forest's funds to non-arm's length parties controlled by Mr. Chan or other members of Inside Management operating under Mr. Chan's instructions.

Use of Nominees

[221] Central to the plaintiff's claim of fraud is the allegation that Mr. Chan secretly controlled many companies, some of which did business with Sino-Forest, through a system of nominee directors and shareholders. Some of these companies, such as China Square, Kun'an, Trevista and Springfield were contracting counterparties with Sino-Forest in transactions, discussed below, which are alleged to have been fraudulent.

[222] The basic concept was that a corporation would be incorporated and Mr. Chan's insiders (friends, business associates and others) would be installed as the titular officers, directors and shareholders of these companies.

[223] Sino-Forest subsidiaries would engage in BVI standing timber and wood log trading transactions with these companies. In the case of wood log trading, substantial funds were paid to these corporations. The titular owners/directors of these corporations would execute undated notices of resignation and removal as directors, and undated share transfer documents. These signed but undated documents would be delivered for safe-keeping to Mr. Chan (through Yosanda, Zeng and perhaps others).

[224] In this way, Mr. Chan could, whenever and for whatever reason he chose, initiate the replacement of the titular owners/directors of these corporations with himself or someone else of his choosing.

[225] The plaintiff relies on numerous email communications referring to the creation and management of nominee companies and nominee shareholder documents. These emails, in some cases, include draft nominee documents such as resolutions removing and replacing directors and approving share transfers.

[226] The plaintiff also relies on a document created by John Zeng. John Zeng was a friend of Mr. Chan's. He was a PRC lawyer. His firm acted for Sino-Forest and for Mr. Chan personally. The document in question was found on Yosanda's computer, last printed January 20, 2011, containing a master list of nominee companies, who controlled them, who managed them and whether a full set of nominee documents had been signed by the nominees. This document is styled "Status of Companies for which the Managers are Nominee Shareholders/which are managed by the managers." I will refer to this document in these Reasons as the Nominee Company Managers List.

[227] Thus, the plaintiff alleges that Mr. Chan used a system of nominee shareholders to hide his beneficial ownership of various companies, including many of Sino-Forest's counterparties. The nominee system was foundational to the fraud that Mr. Chan perpetrated on Sino-Forest and enabled him to conceal the fraud for an extended period of time. Mr. Chan used the nominee system to siphon cash from Sino-Forest to seemingly arm's-length counterparties when, in reality, those counterparties were secretly controlled by Mr. Chan. By funneling Sino-Forest's cash to companies held in the names of his nominees, Mr. Chan managed to impede Sino-Forest's (and, later, the plaintiff's) ability to trace stolen funds to Mr. Chan. Mr. Chan also used the nominee system to set up Sino-Forest's BVI standing timber Suppliers and AIs, and wood log trading suppliers and customers, thus creating the illusion of real arm's-length counterparties that were conducting legitimate transactions.

[228] The defence argues that the scope and sweeping nature of the control alleged to have been exercised by Mr. Chan over this large conglomerate of companies is completely incredible and unfounded. The defence argues that many of the companies falling into this constellation are owned by other Chinese businessmen far wealthier than Mr. Chan and that the idea of them being Mr. Chan's nominees is ludicrous. The defence argues that most of the evidence relied on by the plaintiff in support of these allegations arises from overly exuberant proposals coming from Zeng, proposals that were never consummated or pursued. The defence argues that Mr. Chan, Zeng and other defence witnesses provided credible, plausible explanations for the so-called inculpatory documents relied upon by the plaintiff which demonstrate that there was no system of nominee shareholders and no fraud.

The Nominee Documents

[229] As will be discussed in more detail below, Mr. Chan used nominee shareholders to hide his beneficial ownership of Fortune Universe Ltd. ("Fortune") and Montsford Ltd. ("Montsford") in connection with the Greenheart transactions. Lei Guangyu ("Lei") was Mr. Chan's nominee for Fortune and Zeng was Mr. Chan's nominee for Montsford. In late 2006 and early 2007, Yosanda prepared nominee documents for both Fortune and Montsford, respectively. The documents included:

(a) resolutions and letters by which Lei would resign as the director of Fortune and Zeng would resign as the director of Montsford;

(b) an undated resolution appointing Mr. Chan as the director of each company and Mr. Chan's consent to act as a director;

(c) undated resolutions and instruments of transfer by which Lei transferred his share in Fortune to Mr. Chan for one dollar and by which Zeng transferred his share in Montsford to Mr. Chan for one dollar; and

(d) undated minutes of a meeting for each of Fortune and Montsford documenting the resignations of Lei and Zeng, the appointment of Mr. Chan, and the share transfer to Mr. Chan.

[230] By having Lei and Zeng sign undated copies of these documents, Mr. Chan would have had the ability to take control of Fortune and Montsford whenever he chose to do so.

[231] There is a good deal of evidence that similar arrangements had become widespread by 2010. On February 25, 2010, Zeng sent an email to Mr. Chan, copied to Pauline, explaining how to tighten up the nominee system and exert more control over the nominees. In the opening paragraph of the email, Zeng explained that "[r]egarding the nominee shareholding system, since our last meeting I have been thinking about establishing a comprehensive legal documentation system to protect the benefits of investors." Although Zeng was proposing to improve the system, he warned that "[a]t the end of the day, this documentation system for nominee shareholding is only effective for 'honourable men', but it won't work on those who are not honest."

[232] The improvement developed by Zeng was the introduction of the "declaration statement of property ownership," which, Zeng explained, would protect Mr. Chan's interests more effectively than Mr. Chan's current set of nominee documents:

> Building upon above understanding, the nominee shareholding system that I proposed comprises of two basic sets [of documents]: the first is a declaration statement of property ownership, and the second are blank documents for share transfers. Previously, I found that only share transfer documents are available for your BVI companies; but actually this is not comprehensive at all. A share transfer can only protect our interests "after" the transfer took place, but does not protect the interests before the transfer. It is not comprehensive unless a declaration statement of property ownership is added. (Please see the attachments)

[233] Finally, Zeng explained that Mr. Chan should include the declaration statement for all new nominee arrangements and should attempt to get existing nominees to sign the declaration statement as well. He said:

> With respect to the actual implementation, the complete set of documents must be signed for all new nominee shareholding arrangements. As for existing nominee shareholding arrangements, because no declaration statement was signed, we should ask the nominees to sign it by thinking of a reason or an excuse for it. It may be difficult to do it without making him or her feel that we do not trust him or her. But this can be done if the matter is properly handled. Level of acceptance by the nominees has been taken into account when I drafted the declaration statement, and the statement was written in a "lighter" tone wherever possible. But I don't want to be too hasty. Before the official implementation, I want to find a time to discuss it with you before we proceed.

[234] Attached to Zeng's February 25, 2010 email was a document titled "Proposal for Company Share Integration Management Plan" that set out the comprehensive list of nominee documents, the practice to be instituted, and the risks associated with the system. The practice set out by Zeng was as follows:

- for newly established companies, relevant parties shall sign the nominee shareholder document together with the company registration document.
- in the event of a change of shareholder, share or director at an existing company, relevant parties shall sign the nominee document together with the company registration alteration document.
- in every June, each company shall submit up-to-date financial statements and a shareholder report for the previous year to the main management body.

[235] The risks set out by Zeng were as follows:

- Risks cannot be prevented completely, nominee shareholders may doing the following actions against the interests of the nominated shareholding without the actual investors' knowledge:
    - unauthorized disposal of assets in order to take profit from it;
    - unauthorized transfer of share to a bona fide third-party
    - conducting business operations against the interests of the company (e.g. tax fraud and connected transaction against the interests of the company)

[236] Also attached to Zeng's February 25, 2010 email was a sample declaration statement, the new nominee document described by Zeng in his email. Among other things, the declaration stated that "All the Shares of the Company held by the nominee shareholder is only held on behalf of the principal" and that any gains resulting from the nominee shareholding "belong to the principal." The company on the sample declaration statement is Silver Field International Limited ("Silver Field") and the nominee shareholder is Yu Jing.

[237] A few minutes after Zeng sent the first February 25, 2010 email, he sent Mr. Chan a follow up email stating:

> Besides, regarding some of the new companies - like "the ones with the word 'field' in their names" in Cambodia - I already asked the nominee to sign a set of documents. Should these documents be kept by me? By Eminens? By Yosanda? Or you want to keep them yourself?

[238] There are several companies on the Nominee Company Managers List under Project JP with the word "field" in the company name, including Great Field International Limited, Silver

Field, Great Field (Cambodia) International Company Limited, and Yellow Field (Cambodia) International Company Limited. Zeng confirmed during his testimony that Project JP was a "Cambodia project" and that the "fields in Cambodia as mentioned in this paragraph, they are referring to the investment company names under Mr. Li Hua."

[239] Under "Silver Field" on the Nominee Company Managers List, Li Hua is listed as the manager and Yu Jing is listed as the registered shareholder and director/legal representative. There is a checkmark under the "Documentation Signed by Nominee Shareholder(s)" column, suggesting that Yu Jing had signed the draft declaration statement attached to Zeng's February 25, 2010 email to Mr. Chan. This is consistent with Zeng's statement that he had already asked the nominee to sign a set of documents.

[240] Zeng testified during his examination-in-chief that attaching the declaration statement with Silver Field and Yu Jing was a "mistake" and that he intended to send Mr. Chan a blank statement. He further testified that the document "does not relate to Sino-Forest." Under cross-examination, he changed his story to "I thought very soon Sino-Forest would acquire Mr. Li Hua's company. I thought Sino-Forest would need to see such documents." When asked why he asked whether Mr. Chan or Yosanda should keep what he claimed to be Li Hua's nominee documents, Zeng asserted that there was a translation issue with the plaintiff's professionally certified translation and the intent was only to "show it to Sino-Forest."

[241] Mr. Chan tried to explain the February 25, 2010 emails on the basis that he asked Zeng to do research about the potential risks associated with having nominees hold Chinese assets on behalf of Sino-Forest. Mr. Chan says that the real purpose of the study was related to the "on-shoring" of BVI assets for the benefit of Sino-Forest, but that he withheld the true purpose of the requested research from Zeng.

[242] I am unable to accept this explanation. It is utterly inconsistent with the actual words used in the emails. There is no reference to Sino-Forest, on-shoring or hypothetical nominees holding Chinese assets on behalf of Sino-Forest anywhere in these emails. The language of Zeng's emails makes it clear that the use of nominee shareholders and the supporting documents was not a proposal. There were already signed nominee shareholder documents in place. Zeng described the already-existing set of share transfer documents as being for "your BVI companies" not Sino-Forest. Zeng's "proposal" was to *improve* the protection afforded by the existing share transfer documents by adding a declaration statement. His second email says he has already asked the nominees to sign the documents. He wants to know whether Pauline's company, Mr. Chan's secretary Yosanda, Zeng or Mr. Chan himself will be the caretaker of these documents.

[243] There is also not the slightest evidence that anyone else involved in trying to solve the on-shoring problem of the BVI standing timber assets being locked up in the PRC was aware that Mr. Chan was exploring an elaborate system of nominees, using Zeng and not telling anyone at Sino-Forest about it.

Yosanda Circulates Nominee Documents

[244] Shortly after Zeng's February 25, 2010 email, Yosanda circulated a number of nominee documents for signing. Nominee documents were sent to Lei Guangyu with respect to a company named Global Sugar, and to Jim Lok ("Lok") with respect to companies named Top Revenue International Ltd., Winning Base Investments Ltd, Winner Space Group Ltd., Winner Ally Investments Ltd., and Willfast International Ltd. The relationship of these men to Mr. Chan will be outlined in more detail below.

[245] Global Sugar Group Limited is listed on the Nominee Company Managers List with Lei as a 50% shareholder and director. There is a checkmark under "Documentation Signed by Nominee Shareholder(s)." Similarly, the five companies for which Yosanda sent nominee documents to Lok are listed on the Nominee Company Managers List with Lok as the manager. There are question marks under the "Shareholder", "Director", and "Documentation Signed by Nominee Shareholder(s)" columns.

Zeng's Reporting Email to Mr. Chan

[246] On April 2, 2010, Zeng sent Mr. Chan an email with the subject lines "Outline of instructions to be sought in the meeting next week." In this email, Zeng reported to Mr. Chan and sought Mr. Chan's instructions on nine subjects, including the management of Mr. Chan's nominee arrangements and various projects listed on the Nominee Company Managers List. I will focus on five of these matters.

[247] The first is called: Regarding Real Estate Projects. Under this item in the email, Zeng stated that Mr. Chan needs a "dedicated real estate team." He further stated that they feel "overshadowed by Pang" and cited concerns with "Lei and Li." He ultimately sought Mr. Chan's permission to try a new individual – Xiao Cai of Hesheng.

[248] The first item corresponds to the Beihai Real Estate Project listed on the Nominee Company Managers List, with Li Hua listed as the manager, director/legal representative, and one of the shareholders. The other shareholder is Pang Zhi Zhong.

[249] Mr. Chan and Zeng testified that this item referred to a potential investment by Mr. Chan, but that neither Mr. Chan nor Sino-Forest ever invested in it. However, there is substantial evidence that Mr. Chan invested in the Beihai Real Estate Project and that Lei helped manage the project, including a letter from Lei dated August 27, 2009 stating "[c]urrent status of capital contribution: Pang Zhizhong paid RMB11.29 million and Sino-Forest (you) actually paid RMB41.81 million."

[250] The second item is: Re: Cambodia Project. Under this item, Zeng reported that Li Hua "needs a capable team" and that certain matters "should be done by Li Hua's team, but almost all of them are currently handled by Eminens on his behalf." Zeng further reported "[n]ow that we've spent over ten million dollars on land acquisition and equipment purchases, why don't we

invest a couple of million dollars to set up an efficient management team? In addition, I need your instructions for a few more matters."

[251] This item also corresponds to the Nominee Company Managers List. Zeng testified that Project JP, which was listed on the Nominee Company Managers list with Li Hua as the manager, was a Cambodia project.

[252] Mr. Chan claimed that Zeng sought Mr. Chan's views because Zeng was doing due diligence in Cambodia on Li Hua's company on behalf of Sino-Forest. Zeng, however, was unaware he was doing this due diligence, as Zeng testified that the purpose of seeking Mr. Chan's views was because Zeng, Mr. Chan, and Li Hua were all good friends. Zeng was actually acting for Li Hua. Once again, the more tenable explanation is that which accords with the plain language of the document: Zeng was seeking Mr. Chan's instructions regarding a project management team because Mr. Chan had invested over ten million dollars in the project. Li Hua was Mr. Chan's manager for this project.

[253] The third item is: Re: Suriname Project. Under this item, Zeng stated that "I need to know your thoughts on this matter and the timetable. Another pressing issue is to decide which team we can use. Eminens is understaffed and it might be difficult for it to undertake the project. In addition, I also want to report to you particulars of our DD in the early stage."

[254] Project Suriname appears on the Nominee Company Managers List with Lok listed as the manager.

[255] Once again, Zeng and Mr. Chan had different explanations for this item. According to Zeng, he reported to Mr. Chan on the Suriname project because Mr. Chan "was personally quite interested" but that "at the end, Mr. Chan did not make any investments in this Suriname project." On the other hand, Mr. Chan testified that Project Suriname was "a proposal for Sino-Forest" – not himself.

[256] The fourth item is: Re: Management of Your Private Investment Projects. Under this item, Zeng reported to Mr. Chan specifically on the nominee documents and the supervision of nominees. He wrote:

> At present, there is a complete set of nominee documents for domestic and overseas companies. Some nominees have already signed the documents. For the next step, I need to know: 1. Who else should I contact to sign the documents? 2. Who should keep the signed documents? If you think it is appropriate, I can set up a special desk here and assign a dedicated staff member to follow up. 3. How to get the follow-up done? I suggest that around June each year, all nominees should be required to fill in a fixed form to report to you in writing on changes in equity and changes in assets etc. in the preceding year, so that you will be kept posted about the main investment trends. This will also ensure that the nominees are properly supervised.

[257] Mr. Chan and Zeng gave various contradictory explanations for this passage, none of which could be reconciled with the plain wording of Zeng's email.

[258] Mr. Chan testified that this item referred to "investment potentials" in "media advertising companies," but that he ultimately chose not to invest. In Zeng's affirmation, he claimed that this item set out "the logistical arrangement for these trust documents of the shares of these advertising companies," which were "PRC local companies." During his live testimony, Zeng claimed that the documents that were "already signed" referred to the advertising companies. According to Zeng, the rest of the paragraph was merely a suggestion just in case Mr. Chan ever invested in other companies through nominees. However, Zeng testified that he was "not aware if Mr. Chan had other personal investment projects that could also use such a system."

[259] Zeng steadfastly refused to acknowledge the clear meaning of the words of his own email. For example, the first line of this item states "Re: Management of your private investment projects. At present, there is a complete set of nominee documents for domestic and overseas companies." During cross-examination, when asked if Zeng denied that "what's clearly going on here is you're reporting that you have a complete set of nominee documents prepared for Mr. Chan's personal investments, both domestically and overseas", Zeng responded:

> I totally disagree with the speculation put forth by the plaintiff, which is unfounded and not logical. If you read carefully the text before this paragraph and after the paragraph, if you follow the logic and if you look for the true meaning of the text, you would understand this is totally unfounded speculation.

[260] Despite Zeng's refusal to acknowledge the words of his own email, this matter is plainly a follow-up to Zeng's February 25, 2010 email in which Zeng had explained how to improve the nominee system. In the April 2, 2010 email, Zeng is reporting that more nominees had signed the documents, once again asking Mr. Chan who should keep the executed nominee documents, and once again suggesting that nominees be required to report to Mr. Chan in writing on an annual basis to ensure proper supervision. There is no mention of domestic advertising companies. By contrast, there is an express reference to overseas companies, which is left unexplained by both Mr. Chan and Zeng. Moreover, the email simply cannot be read to indicate that this was nothing more than a suggestion by Zeng in the event that Mr. Chan decided one day to invest through nominees in projects currently unknown.

[261] The fifth item I will address from this email is: Re: Russia Project. Under this item, Zeng reported to Mr. Chan on concerns with Ho's performance as part of Project Russia and asked Mr. Chan how to place Ho in a proper position.

[262] This item also corresponds to the Nominee Company Managers List, on which Ho is listed as a manager of Project Russia. As discussed later in these Reasons in connection with the wood log trading frauds, Zeng's office set up a number of BVI companies under Project Russia which appear on the Nominee Company Managers list and in respect of which Ho reported to Mr. Chan as manager of that project.

Signed Nominee Documents for the Peripheral Companies

[263] On May 21, 2010, Zeng reported to Mr. Chan that he got the nominee documents signed for a series of peripheral companies:

> This is an overview of the peripheral companies of Panel, which as of today have basically signed "nominee holdings documents" with their shareholders and legal representatives. We will follow-up regularly with the new peripheral companies established in the future and any substantive changes at the old companies.

[264] Attached to Zeng's email was a list of the peripheral companies. The list included some of Sino-Forest's standing timber suppliers, with Huang Ran listed as the administrator of those companies, various individuals listed as the legal representatives, and other individuals listed as the shareholders. Ten of those suppliers are listed on the Nominee Company Managers List with Huang Ran listed as the manager and the same individuals listed as the legal representatives and shareholders.

[265] Xunxiang was also listed on the attachment to Zeng's email, with Li Hai Bo listed as the administrator, legal representative, and one of the two shareholders. The other listed shareholder is Zhang Jun Feng. Similarly, Xunxiang is the next company on the Nominee Company Managers List, with Li Hai Bo listed as the manager, legal representative, and one of the two shareholders, with the other shareholder being Zhang Jun Feng.

[266] The explanations provided by Mr. Chan and Zeng for this email do not hold up to scrutiny. Mr. Chan testified that this email was "part of this on-shoring studies" and that "we want also to know who we are dealing with, who are the real boss of these companies."

[267] Mr. Chan admitted, however, that none of this was disclosed to Zeng, who was actually doing the work. Mr. Chan's explanation that Zeng was doing exploratory research on nominee arrangements for on-shoring is uncorroborated by any independent Sino-Forest source, such as independent Board members or professional advisors. On-shoring was the most significant strategic problem facing Sino-Forest – how to extract the increasing value of BVI standing timber assets out of the PRC and deal with the regulatory, tax and other potential problems associated with extracting that value.

[268] Given the importance of this issue, and the glacial pace at which it was being addressed, it would reasonably be expected that the consideration of a potential solution would have been known to the Board and the independent professionals charged with finding a solution. There is not a hint of this in the evidence. Instead, Mr. Chan was off on his own, using a lawyer who acted for Mr. Chan personally.

[269] Zeng testified that the purpose was to "understand the identity of the real shareholders behind these companies. Sino-Forest could use such investigation to identify potential competitors who could be using such nominee shareholding format to conceal their real identity so that they could get close to Sino-Forest."

[270] During cross-examination, Zeng admitted that the whole point of a nominee arrangement is to hide the beneficial ownership. It makes no sense that counterparties and potential competitors who were trying to hide their identities from Sino-Forest would share their nominee arrangements with Sino-Forest.

[271] Most importantly, both Mr. Chan and Zeng's explanations fly in the face of the plain language of the email itself. When considered in conjunction with Zeng's February 25 and April 2, 2010 emails regarding getting the nominee documents signed for Mr. Chan's companies, the simplest and most plausible explanation, and the explanation most in accord with the probabilities of the case, is that Zeng was reporting to Mr. Chan that he got more nominees to sign the nominee documents. This time, it was the nominees for companies they called the "peripheral companies" that included companies Sino-Forest did business with on a supposedly arm's length basis.

The Nominee Company Managers List

[272] What the plaintiff has styled the "nominee companies caretaker list" was, according to Zeng, created by Kelly Xie, who worked for Zeng, under his direction. The metadata of the document shows – and Yosanda confirmed – that it was originally created by Kelly Xie, accessed and printed by Yosanda on January 20, 2011, and found in Yosanda's electronic recycling bin.

[273] The title of the document, which the plaintiff had professionally translated, explains what the document is: "Status of Companies for which the Managers are Nominee Shareholders / which are Managed by the Managers."

[274] The Nominee Company Managers List has eleven columns:

(1) "No" – "No" is short-form for number. This column assigns a number to each manager. There are ten managers in total.

(2) "Manager/No. of Companies" – This column sets out the names of the managers and the number of companies they manage. The managers are Pauline, Li Hua, Ho, Chen, Huang Ran, Li Hai Bo, Lok, Liu Feng, Zeng, and Marco Lam.

(3) "Project" – This column sets out the names of the projects that are managed by the managers (e.g. Project Russia).

(4) "Company name" – This column sets out the names of the companies under each project.

(5) "Place of Incorporation" – This column sets out the jurisdiction in which each company was incorporated.

(6) "Registered Shareholder" – This column lists the shareholders of each company.

(7) “Director/Legal Representative” – This column lists the directors and legal representatives of each company.

(8) “Date of Incorporation” – This column sets out the date on which each company was incorporated.

(9) “Documentation Signed by Nominee Shareholder(s)” – this column contains a checkmark, an “x”, a question mark, or another note indicating whether the nominees of each company have signed the nominee documents.

(10) “Financial Data” – This column is blank for every company.

(11) “Note” – This column contains miscellaneous notes regarding a few of the companies.

[275] Many of the companies on the Nominee Company Managers List did business with Sino-Forest, including PhytoGaa, the peripheral companies, Trevista, Spring Field, the companies under Project Erenhot, and more. Others were companies in which Mr. Chan personally invested, including Shenzhen Hongji Investment Development Limited (“Shenzhen Hongji”) and Beihai Faye Real Estate Development Company Limited (“Beihai”), the details of which are set out below.

[276] Zeng’s evidence is that in 2010, he and some friends, including Mr. Chan, had an idea of forming a conglomerate of companies focusing on the “green” concept.

[277] He asked Kelly Xie, one of the lawyers at his law firm, Kai Tong, to compile a list of companies for consideration. He says he gave no concrete instructions on which companies or what data to include. But, for PRC companies he wanted to know the “true owners” and therefore to know if the registered shareholders were mere nominees or the true owners. From this data, he said, he hoped to identify five or six large companies that would create high volume for a public listing by way of initial public offering (IPO).

[278] Zeng said he told Kelly Xie to put the draft IPO list on a USB key so he could take it to Hong Kong for a meeting with Mr. Chan. When he arrived in Hong Kong, he asked Yosanda to print it out for him, which is how it ended up on Yosanda’s computer.

[279] When he saw the document, however, he said he found it was full of errors and that he could not make sense of some parts of it. Zeng says, for example, that Ho was not the manager of any of these companies listed under Project Russia (although this contradicts his email of April 2, 2010 specifically commenting on Ho’s performance in this role, not to mention Ho’s evidence at trial, where Ho admitted he was the manager of Project Russia).

[280] Zeng says the title of the document is wrong. The managers are not the nominee shareholders. Although Zeng testified through a translator, he felt comfortable taking issue with some of the translation.[2]

[281] Zeng says this list has nothing to do with Mr. Chan and that none of the shareholders listed are Mr. Chan's nominees.

[282] Mr. Chan disclaims all knowledge of this document and any connection to any of these companies. He brushes it off as another one of Zeng's hare-brained schemes.

[283] Kelly Xie did not testify.

[284] In my view, there is virtually no respect in which Zeng's explanation of this document makes any sense. The very idea of randomly throwing some large companies together into a conglomerate to issue an IPO is inherently ridiculous.

[285] Zeng did not produce a single document to corroborate his IPO story. Zeng's story does not conform in any way to the document itself. The document is not called "List of Potential IPO Targets" nor does the term "IPO" appear in the document. There is no reference to forming a "green" conglomerate to issue an IPO in any contemporaneous document.

[286] Zeng's explanation for why there is reference to nominee shareholders is also illogical and contradictory. He says he wanted to know who the "true owners" were of these potential "conglomerate" partners. He could not explain why independent, arm's length companies that had gone to the trouble of establishing nominee shareholder structures would share that information with Kelly Xie, since the whole point of establishing a structure like that would be to conceal who the real shareholders were.

[287] There is no corroborative evidence for the suggestion that any of these companies were large, successful enterprises. The evidence tends to the opposite conclusion, as a number of the companies listed were in contractual relationships with Sino-Forest, defaulted on their obligations and disappeared after the Muddy Waters Report.

[288] There is simply no coherent explanation for why there would need to be a designation of "managers" at all, or why a list of IPO candidates would be organized into "Projects" which, ultimately, were shown to reflect a number of business areas or activities in which Mr. Chan was, or shortly became, active.

[2] As noted earlier, if translation was in issue, the proper way to address it was by filing a competing translation by a qualified expert. This was not done. I do not accept Zeng's attempted retranslation of the document.

[289] Zeng's story is inconsistent with a significant volume of evidence tying the listed nominees and companies back to Mr. Chan or members of Inside Management and showing Mr. Chan's involvement in incorporating and managing those companies.

[290] For example, although Zeng says Ho was not a manager of any of these companies, as will be discussed below dealing with Project Russia in the context of wood log trading, Ho and Zeng were both central to the creation and establishment of several companies under Project Russia which are listed on the Nominee Company Managers List. Ho was explicitly and admittedly the manager of Project Russia, in which Sino-Forest ended up doing tens of millions of dollars of wood log trading.

Yosanda's Role in Implementing the Nominee System

[291] Yosanda was Mr. Chan's secretary at Sino-Forest. Maradin referred to Yosanda as "the gate keeper in terms of getting access" to Mr. Chan. By his own admission, Mr. Chan engaged in very little electronic communication. Emails for example, intended for Mr. Chan were typically sent to Yosanda. Mr. Chan's responses were often from Yosanda. Many emails addressed to Yosanda are clearly intended for Mr. Chan.

[292] Yosanda agreed she was responsible for monitoring Mr. Chan's email account. She said she printed out emails and delivered copies to him.

[293] Yosanda continues to have an ongoing financial and working relationship with Mr. Chan. She received a HKD$2.7million loan from Mr. Chan in 2011. She continued to work for him to the date of trial. Yosanda said she "paid off" her loan to Mr. Chan by continuing to work for him without compensation.

[294] Yosanda was paid a large salary for an assistant. This is an indication of her importance to Mr. Chan and the operations and management at Sino-Forest.

[295] Some reference has already been made to Yosanda's involvement in the preparation and circulation of nominee documents. This will come up again in a number of other contexts as individual transactions are considered.

[296] Yosanda also assisted with the incorporation and administration of many of the companies on the Nominee Company Managers List, including Global Sugar, Grand Eastern Development, Elderbridge, and Findhelm. Yosanda also assisted with the incorporation and administration of Fortune and Montsford, which were Mr. Chan's nominee companies for Greenheart.

The Nominees and Managers

[297] The relationship of many of the alleged nominees and managers to Mr. Chan is material to the overall picture. These are names which come up repeatedly in the analysis of particular transactions. I will therefore set out at this point who the nominees and managers are, outline

what their relationship was to Sino-Forest and to Mr. Chan and foreshadow the evidence of their role in the conduct of business with Mr. Chan and Sino-Forest.

(a) Lei Guangyu

[298] Lei was involved in managing Mr. Chan's personal investments and held interests in companies as Mr. Chan's nominee such as Fortune, which invested in Greenheart. He is also listed as the nominee shareholder of several companies on the Nominee Company Managers List and received draft nominee documents from Yosanda in respect of Global Sugar.

[299] Mr. Chan denies that Lei ever acted as his nominee. Lei, similarly, initially testified that he never held an interest for Mr. Chan as a nominee and that Mr. Chan and Lei never invested in the same project or company at the same time.

[300] In cross-examination, Lei resiled from his prior evidence and admitted that he had in fact previously held money and shares on behalf of Mr. Chan. Some of Lei's activities in relation to investments with Mr. Chan are outlined below.

(i) Shenzhen Hongji

[301] Shenzhen Hongji appears on the Nominee Company Managers List with Lei listed as the director/legal representative. Lei says this was his company. Shenzhen Hongji's predecessor company was Hongji Industrial, which was later restructured into Shenzhen Hongji in 2002. Lei testified that he kept money belonging to Mr. Chan in Hongji's account when the money was idle. There were no accounts or documents setting out the amount or disposition of these funds.

[302] On October 25, 2006, Lei wrote to Mr. Chan regarding a proposed investment in Shenzhen Hongji by another individual named Mr. Shi. Although the investment would increase the capital of Shenzhen Hongji, Lei warned that "[t]he percentage of the original shareholders will be diluted." Lei told Mr. Chan that the capital increase was "pending your approval."

(ii) Recent Fortune

[303] Lei also controlled a company called Recent Fortune Group Ltd. ("Recent Fortune"). Recent Fortune was supposed to be an arm's length remittance agent that remitted money to Sino-Forest on behalf of its wood log customers.

[304] On March 3, 2010, Lei sent Hung bank account details for Recent Fortune. Lei also used Recent Fortune to invest money as Mr. Chan's nominee.

(iii) Beihai Real Estate Project[3]

[3] It should be noted that the Beihai, Wuxi and Changshou projects were not directly implicated in any fraudulent activity or transactions. The plaintiff focusses on these transactions in support of

[305] Beihai appears on the Nominee Company Managers List, with Li Hua and Pang Zhi Zhong listed as the registered shareholders. There are multiple letters from Lei to Mr. Chan describing Mr. Chan's investment in Beihai, reporting on the Beihai project to Mr. Chan, and seeking Mr. Chan's instructions with respect to the project.

[306] In a letter from Lei to Mr. Chan dated June 24, 2009, Lei proposed that Sino-Forest invest in Beihai. The total amount to be invested in Beihai was RMB12 million. RMB7.8 million was to be paid by "Sino-Forest," which would amount to 65% of the investment. The remaining 35% (being RMB 4.2 million) was to be paid by Hongji. Following the June 24, 2009 letter, Lei sent numerous letters to Mr. Chan reporting on the status of the project and seeking Mr. Chan's instructions with respect to various issues.

[307] In a letter from Lei to Mr. Chan dated August 27, 2009, Lei described the current capital contribution of Beihai as: "Pang Zhizhong paid RMB11.29 million and Sino-Forest (you) actually paid RMB41.81 million" indicating that Mr. Chan or Sino-Forest had invested at that point in time. There is no evidence that Beihai real estate was ever a Sino-Forest asset.

[308] In a letter dated December 9, 2010 from Lei to Pang Zhi Zhong copied to Mr. Chan, Lei stated "[d]uring the waiting period, if an appropriate buyer is interested in this project, (we) can consider to sell 65% shares of Sino-Forest and Hongji." In a letter dated December 10, 2010 from Lei to Mr. Chan, Lei wrote: "There is currently a technical problem facing the acquisition of the Beihai project. Shi and others acquire 100% shares under their names but they can only raise approximately RMB$40 million of funds (only sufficient to acquire Pang's 35%). Does our 65% need to be paid as a matter of form?"

[309] Mr. Chan's evidence is that Lei was confused. Mr. Chan testified that these were never more than proposals and that neither he nor Sino-Forest invested in this project. There is nothing about the communications, however, to suggest these were proposals. These emails are discussing existing interests. The interaction also shows the degree of financial integration Mr. Chan had with Lei.

(iv) Wuxi Furniture Factory

[310] On January 1, 2011, Lei sent Mr. Chan a letter advising that "the owner of our leased factory wishes to transfer it in its entirety due to financial difficulty." The factory was called the Wuxi Ziyunxuan Rosewood Furniture Co. Ltd. After setting out the details of a proposed transaction, Lei set out the current shareholders of the factory and their respective ownership interests. As set out by Lei, Mr. Chan was the majority owner and Lei held Mr. Chan's shares as Mr. Chan's nominee. Lei wrote:

the proposition that Mr. Chan held beneficial interests in companies through nominees, such as Lei, who took instructions from Chan on business matters affecting those companies in recognition of Mr. Chan's beneficial interest.

a. You hold 51%, investing RMB2.55 million. (held by Lei on your behalf)

b. Marco Lam holds 20%, investing RMB1 million

c. Lei Guangyu holds 19%, investing RMB950,000.

[311] Mr. Chan's evidence at trial contradicted the plain language of this message. Mr. Chan testified that Lei's letter was merely a proposal and that he did not invest.

[312] However, on July 9, 2010, Guo Zhibiao, who worked for Lei, sent Hung a document titled "SINOFOREST's Statement of Fund Flow Balance." The document listed "funds received" and "funds expended." Under "funds expended," one item was "Purchase of equity capital of Wuxi Ziyunxuan Furniture Company" for RMB2,550,000. The figure corresponds exactly to the amount that Lei stated that Mr. Chan invested in the aforementioned letter. Lei testified that "this is just a coincidence."

(v) Changshou Road

[313] Another project listed under "Funds Expended" on the "SINOFOREST's Statement of Fund Flow Balance" is the Changshou Road project, which was located in Shanghai.

[314] On October 15, 2009, Lei sent a letter to Mr. Chan recommending that Mr. Chan invest in the Changshou Road real estate project. On April 12, 2010, Lei sent Hung an email advising that "Allen directed that the two of us were to be responsible for carrying out the specific tasks" regarding the "property projects."

[315] From April 27, 2010 onwards, Lei and Hung corresponded regularly regarding the Changshou Road project. On May 17, 2010, Lei told Hung to "transfer the USD funds required by the Shanghai project into the following account" and then set out the account details for Recent Fortune. The "Funds Received" section of the "SINOFOREST's Statement of Fund Flow Balance" shows that $3,000,000 was received three days later. As depicted by the "Funds Expended" section and stated by Lei in his letters to Hung, Lei then used that money to invest in the Changshou Road project on behalf of Mr. Chan.

(b) Pauline Chan

[316] Pauline is listed as the manager of three companies of the Nominee Company Managers List. Zeng testified that Pauline's company, Eminens, managed those companies. In Zeng's April 2, 2010 reporting email to Mr. Chan, he reported that Eminens was getting involved in "more and more operations."

[317] In 2009 or 2010, Mr. Chan claims to have loaned Pauline about HKD$3.1 million but did not formally document the loan. Since the Litigation Trust obtained a *Mareva* injunction over Mr. Chan's worldwide assets in August 2014, Mr. Chan's evidence is that Pauline has been paying for his personal expenses.

(c) Li Hua

[318] Li Hua is listed as the manager of 22 companies on the Nominee Company Managers List and as the nominee shareholder of several companies.

[319] One of the projects listed as managed by Li Hua is the Beihai project. In Lei's August 27, 2009 letter regarding Beihai, discussed above, Lei stated that the shareholders of Beihai were Mr. Chan and Pang Zhi Zhong. He also explained that Li Hua was assisting Lei with negotiations regarding the project. On the Nominee Company Managers List, the "registered shareholders" of Beihai are listed as Li Hua and Pang Zhi Zhong.

(d) George Ho

[320] Ho was the Chief Financial Officer and Vice President Finance of Sino-Forest from October 2009 to April 2012. Ho is listed as the manager of 16 companies on the Nominee Company Managers List. Along with Jack Chen, Ho was responsible for managing Project Russia. In connection with Project Russia, Ho assisted Mr. Chan in hiring Jack Chen and setting him up as Mr. Chan's nominee.

[321] Ho also received an interest free HKD$2 million "loan" from Mr. Chan in August 2009 that Ho has not paid back. The terms of the loan were not documented in any way.

(e) Jack Chen

[322] Chen is listed as the manager of 15 companies on the Nominee Company Managers List, all under Project Russia. He is listed as the nominee shareholder and director/legal representative of several of those companies, including Grand Eastern Development and Trevista International Limited ("Trevista").

[323] Chen was originally hired by Mr. Chan and Ho to work for Eminens. Chen was ultimately placed in charge of the GED group, which included Sino-Forest's wood log supplier, Trevista, and wood log customer, Spring Field, in connection with Russian wood log trading.

(f) Huang Ran

[324] Huang Ran was a former employee of Sino-Forest. He joined Sino-Forest in about 1997 and left in about 2007.

[325] Huang Ran is listed as the manager of ten companies on the Nominee Company Managers List, some of which were BVI and WFOE standing timber suppliers. He is also the nominee shareholder of some of these companies. Although not listed, Huang Ran was also a nominee/manager of Yuda Wood, which was Sino-Forest's largest BVI standing timber supplier.

[326] One of the Suppliers listed as being managed by Huang Ran is Guangxi Hezhou Kun'an Forestry Company Limited ("Kun'an"). There is email correspondence from Inside Management

making it clear that Ran was responsible for making Kun'an look like a real company, not an "empty shell."

(g) Li Hai Bo

[327] Li Hai Bo is listed as the manager, nominee shareholder, and director/legal representative of Xunxiang. Xunxiang received a deposit of over $85 million from Sino-Forest for wood logs that were never delivered. The plaintiff alleges that this was one of the wood log deposit frauds involving an undisclosed related party transaction. Sino-Forest, following the Muddy Waters Report, eventually obtained a substantial arbitration award against Xunxiang, only a small percentage of which was ever recovered.

(h) Jim Lok

[328] Lok is listed as the manager of 54 companies on the Nominee Company Managers List and as the nominee shareholder and director/legal representative of some of those companies. Yosanda sent Lok nominee documents for at least five companies listed as being managed by Lok.

[329] In his affirmation, Mr. Chan testified that Lok had been the Consul to Suriname for more than 15 years and was a career diplomat for the PRC government. Mr. Chan's evidence was that "it was a ridiculous suggestion by the Plaintiff that I could control Jim Lok." During cross-examination, Mr. Chan also denied that Lok ever worked for him.

[330] However, a number of text messages from Lok to Yosanda (for Mr. Chan's attention) tell a different story. In these messages, Lok referred to Mr. Chan as "King"; and confirmed that he had worked for Mr. Chan for many years. For example, in one series of text messages that Lok send to Mr. Chan, Lok stated:

> King, regarding the Hunan matter this morning I've been thinking about it and decided to send you a SMS directly. I heard that Marco [Lam] questions whether the project can be listed and is suspicious of me so I thought I'd better explain to you.
>
> Firstly, I have always been involved in this project and to date have obtained the approval for listing. Secondly, this fundraising has been popular with Hunan, I saw an opportunity to obtain high return as well controlling this company in the future, hence why I suggested the investment.
>
> This time the fundraising raised 59 million. 10 million from Hunan was available a month ago.
>
> Thirdly, if the issue is not as I described, then it's my personal integrity that is the problem. All these years working for you I'm most concerned about you

> misunderstanding me. Whatever issue can be resolved, I resolved them myself as I didn't want to bother you.
>
> Although up to now I have not made much profit for you, you know that I am competent. I won't disappoint you and also hope that you will trust and support me like before. I will definitely be successful, of that I am confident of.
>
> Fourthly, King, I am really tired now. Although I appear to be successful but in reality I don't have anything. It's year-end again and many things have not been resolved. Also there were many instances where I couldn't go ahead even where there was an opportunity.
>
> I can't say this in person. Although the SMS is not well written and you may not see it clearly, but this represents my current honest thoughts. Thanks.

(i) Liu Feng

[331] Liu Feng is listed as the manager of 10 companies under Project Cambodia. There is little other information.

(j) John Zeng

[332] Zeng is listed as the manager of five companies on the Nominee Company Managers List and the nominee shareholder and director/legal representative of four of those companies. There are checkmarks under the "Documentation Signed by Nominee Shareholder(s)" column for all five companies managed by Zeng.

[333] As will be reviewed in the section of these Reasons dealing with Greenheart, Zeng also held Montsford's interest in Greenheart on Mr. Chan's behalf.

(k) Marco Lam

[334] Marco Lam is listed on the Nominee Company Managers List as the manager of China Square Industrial Limited ("China Square") which was a wood log supplier for Sino-Forest.

[335] Lam was a friend of Mr. Chan's and worked at Sino-Forest from 2001 to 2007.

[336] Lam made payments at the direction of Mr. Chan and Inside Management, including a HKD$5 million payment to Jack Chen, a salary bonus to James Lau who was a Sino-Forest employee, and a $1 million payment to Sino-Forest so that Sino-Forest's auditors would not write off a wood log deposit paid to Elderbridge, one of Lam's companies held as nominee for Mr. Chan.

[337] Lam and his companion, Peggy Lo, were also involved in the purchase of Mr. Chan's personal residences in Hong Kong. In particular, Lam paid for the residences at Mr. Chan's

direction. The registered owner of the properties is a company named Shiny Tech Hong Kong Limited (Shiny Tech). From September 21, 2007 until 2011, under declarations of trust, Peggy Lo held the shares of Shiny Tech in trust for Mr. Chan's daughters Joyce and Grace Chan. Mr. Chan agreed during cross-examination that he only trusted Peggy to hold the shares of Shiny Tech due to his trust and faith in Lam.

[338] Lam also ran Prompt Sky. Prompt Sky received a $25 million wood log deposit under a contract dated February 14, 2011 that was signed by Mr. Chan on behalf of Sino-Forest and Peggy Lo on behalf of Prompt Sky.

[339] On February 19, 2011 – four days after Sino-Forest entered into the Prompt Sky transaction – Mr. Chan's lawyer, May Tsui, sent Yosanda an email advising that she prepared documents in respect of the resignation of Peggy Lo and the appointment of Grace and Joyce as directors of Shiny Tech. Peggy Lo then transferred the shares of Shiny Tech to Grace and Joyce pursuant to instruments of transfer dated March 1, 2011.

[340] Mr. Chan's evidence is that it was just a coincidence that Peggy Lo resigned from her trusteeship for Shiny Tech shortly after signing the Prompt Sky contract. I find the more probable explanation is that Mr. Chan was concerned with the appearance of Sino-Forest entering into a transaction to pay a $25 million unsecured deposit to a counterparty that was controlled by Peggy Lo, who also held the shares of the company that owned his residence in trust.

[341] Further details about many of these people and their relationships and financial dealings with Mr. Chan and Sino-Forest, will be reviewed in the context of specific allegations, analyzed in the next several sections of these Reasons.

Conclusion on the Use of Nominees

[342] The evidence, taken as a whole, overwhelming supports the conclusion that Mr. Chan established a complex network of relationships with third parties, including Lei, Ran, Lam, Chen, Zeng and others, in which they acted as his nominees, holding positions as directors and officers and shareholders in corporations beneficially owned or controlled by Mr. Chan. These relationships were never disclosed to Sino-Forest. Indeed, following the release of the Muddy Waters Report, they were denied.

[343] Many of these companies such as Yuda Wood, Kun'an and China Square, did hundreds of millions of dollars of standing timber and wood log trading with Sino-Forest.

[344] A critical component of the BVI model and Sino-Forest's wood log trading was that the transactions were at market value and represented the acquisition of valuable assets (in the form of standing timber and wood logs). This depended absolutely on the counterparties being *bona fide* arms' length entities. The conclusion that many of Sino-Forest counterparties were not *bona fide* arms' length entities, but were secretly controlled by Mr. Chan or other members of Inside Management working under Mr. Chan's direction, guts the whole BVI model, as well as the wood log trading model, of any semblance of validity.

The BVI Model Fraud

Overview

[345] The BVI model involving the purchase and sale of standing timber in the PRC was the main contributor to Sino-Forest's incredible growth. By 2011, the BVI model accounted for 50% of Sino-Forest's reported assets, 61% of its reported revenues, and 95% of its reported profits. The 2011 second quarter financial statements showed the BVI standing timber assets valued at $2.99 billion.

[346] The plaintiff argues that the entire BVI standing timber model was a fraud. He describes the fraud as follows.

[347] A Sino-Forest BVI and a Supplier entered into an agreement for the purchase of standing timber. The Supplier entered into the agreement on behalf of the original owner, typically a rural collective or village.

[348] The Sino-Forest BVI would hold the standing timber for two to three years before selling it. Sino-Forest did not sell to end users. It sold to AIs under an entrusted sales agreement. The AIs were responsible for sales to end users. The AIs were also responsible for payment of all taxes arising out of the transaction.

[349] The BVI model was cashless. Sino-Forest did not pay cash to the Supplier and did not receive cash from the AI. Instead, Sino-Forest instructed its AIs to settle Sino-Forest's receivable by paying funds directly to a Supplier to whom Sino-Forest owed a payable. The directed payments by AIs for their purchase of standing timber was typically never to a Supplier in respect of the same standing timber plantation. The directed payments were further complicated by the fact that the Suppliers often designated third or fourth parties as their payees to receive payment, and the AIs often designated third or fourth parties as their payors to make the required payments.

[350] There is no objective evidence to support the existence of cash flows between the AIs and the Suppliers. Before the Muddy Waters Report the AIs "paid" Sino-Forest's accounts receivable 100% of the time and, in fact, paid on average 141 days in advance of their contractual obligations. After the Muddy Waters Report, collections went from 100% to 0%, leaving $877 million of unpaid outstanding accounts receivable.

[351] Nor is there any objective evidence that any of the tax liabilities, the responsibility of the AIs, were ever paid.

[352] Under the purchase agreement, Sino-Forest lacked key documents to establish ownership or identify the location of the standing timber plantations. This included plantation rights certificates issued by the local forestry bureaus and villagers' authorizations for the purchase from the local village or collectives. This lack of documentation means that, even now, six years after the Muddy Waters Report, no compartment of standing timber has ever been proven to be the

property of Sino-Forest and virtually none (barely 1%) of the compartments of BVI standing timbers have even been located.

[353] Sino-Forest likewise provided no title documents or maps or other means of identifying the location of the standing timber sold to the AIs. These documents were necessary to obtain permits to harvest the timber. Although Sino-Forest was contractually bound to assist the AIs to obtain the necessary permits to harvest, no AI or customer ever sought that assistance. There is also no evidence that any AI or customer ever applied to harvest standing timber sold by Sino-Forest to the AI.

[354] In lieu of key ownership documents, Sino-Forest prepared virtually identical forestry bureau confirmations for execution by 66 different local forestry bureaus in nine different provinces. These confirmations all provided that the local forestry bureau was, at the time, unable to issue a plantation rights certificate but that the bureau "will do so immediately" once its plantation rights certificate regime was up and running.

[355] The defendant's forestry law expert testified that, by 2009, 51% of the forested areas in China had issued plantation rights certificates; by 2010 it was over 82%; in 2011 over 86%; and by 2013, it was almost 98%. In not one case, however, in over 500 contracts from 2004 to this day, has any local forestry bureau ever issued a plantation rights certificate to any Sino-Forest BVI in respect of any BVI standing timber plantation acquired by Sino-Forest.

[356] All the key contractual documents, including the purchase agreements, the entrusted sales agreements, the set off documents and the forestry bureau confirmations were prepared by a Sino-Forest employees working for Hung after the end of each quarter with respect to all transactions in that quarter.

[357] Mr. Chan and Inside Management had undisclosed connections to many of the BVI standing timber Suppliers and AIs. The plaintiff argues that:

i) many of the Suppliers had shareholders, officers or contact persons who were former Sino-Forest employees who appear on the Nominee Company Managers List;

ii) a number of the Suppliers themselves appear on the Nominee Company Managers List;

iii) Sino-Forest employees including Inside Management were involved in establishing and administering the affairs (including financial affairs) of many of the Suppliers;

iv) following the release of the Muddy Waters Report, site checks by Sino-Forest's former auditors, the IC's advisors and the Monitor revealed that many Suppliers and AIs had deregistered as corporations or could not be located at the business addresses provided. Most simply evaporated; and

v) similarly, efforts by the IC's advisors and the Monitor to verify that funds actually flowed from AIs to Suppliers were 100% unsuccessful. The Suppliers and AIs either could not be found or refused to disclose any relevant information.

[358] Thus, the plaintiff argues that the BVI standing timber model was a fraud. The Suppliers and AIs who sold and bought the BVI standing timber were not *bona fide* arm's length counterparties. These counterparties were controlled by Mr. Chan or other members of Inside Management operating under his direction. The entire BVI standing timber trading business was a fiction. There were no standing timber compartments bought and sold, there was no money paid by AIs to Suppliers. It was all a scam to inflate Sino-Forest's asset values, boost its share price and enable Sino-Forest to raise money on the debt and equity markets. The proceeds of those capital raises were used by Mr. Chan to create and operate this fraudulent business and, with the help of Inside Management, were diverted to Mr. Chan for his own benefit.

[359] The defendant agrees there was a fraud: he says, however, that the fraud was perpetrated by Muddy Waters. The defendant alleges Muddy Waters shorted Sino-Forest stock and then published a false, extremely negative report about Sino-Forest in order to make hundreds of millions from its investment when the share price declined. The defendant points to the fact that Sino-Forest actually commenced an action against Muddy Waters on precisely this theory. The defendant faults Sino-Forest for not pursuing that action for what he says was the real fraud on Sino-Forest.

[360] Fundamentally, the defendant maintains that the BVI standing timer model was *bona fide* and that Sino-Forest owned 520,000 ha of standing timber with a value of some $2.9 billion. He denies that he exercised any control over Sino-Forest counterparties and denies all allegations of fraud. The defendant says the bondholders acted precipitously, failed to exercise due diligence in establishing Sino-Forest's ownership of its assets and improperly pulled the plug on Sino-Forest, causing its business model to collapse

[361] The evidence leads me to the conclusion that, on a balance of probabilities, the plaintiff is right. The BVI standing timber model was a fraud. My reasons for coming to this conclusion are set out below.

Shortcomings in the BVI Model Purchase Contracts and Underlying Documents

[362] Sino-Forest's BVI model purchase contracts stated that they attached plantation rights certificates, villager's authorizations, and survey reports. However, none of these contracts had attached a plantation rights certificate or a villager's authorization, nor did Sino-Forest have these documents in any other form. The "survey reports" that were attached were proven to be too vague to be of any use. The forestry bureau confirmations that Sino-Forest possessed were not sufficient to establish ownership or to locate the standing timber plantations. As a result, Sino-Forest lacked the requisite documentation to find the standing timber assets, much less prove that it had any ownership interest in them.

The Contracts Were Vague and did not Comply with Industry Standards

[363] The defendant argues that Mr. Borrelli has advanced his theory of fraud in the BVI standing timber model on the basis of one "sample" transaction, and that fraud cannot be proved through "samples." This is not an accurate description of what Mr. Borrelli has done. All of the purchase and sale contract documentation is in evidence and available to both parties. Mr. Borrelli testified that the transaction structure and documentation is essentially the same in all 525 contracts. Trial and judicial economy dictated that, unless absolutely necessary, time should not be devoted to the proof of every piece of documentation for every BVI standing timber transaction (there are 525 transactions in issue). If the defendant wanted to quarrel with Mr. Borrelli's assertion and show the transactions and documentation were not all essentially the same, he had all of the raw material necessary to do that. With a few extremely minor exceptions, no effort was made to contradict Mr. Borrelli's assertion that the standing timber deal structure and documentation was essentially all the same for every transaction. Mr. Borrelli's approach was appropriate in the absence of evidence that more detail was required. There was no such evidence.

[364] The BVI model purchase contracts state that the Sino-Forest BVI was purchasing a certain area of forest within a certain province in the PRC. The sample purchase agreement (which is representative of all of the BVI standing timber purchase contracts) states that the BVI subsidiary was purchasing 52,426 mu of broad-leaved trees in Gengma County.[4] No other information is provided identifying the specific location of the trees. Sino-Forest did not have any maps in its records for its BVI assets. Although the verification reports were intended to identify the location of the trees, they were deficient in numerous respects and were insufficient to locate the vast majority of the BVI standing timber assets.

[365] Song Li, the Litigation Trust's PRC forestry expert, concluded that there were serious problems with the documentation, such as uncertainty of the purchased subject matter and lack of detail concerning the tree species and the type of transferred plantation rights. He described a map as "indispensable in forest transactions" and concluded that "the absence of a map in a transaction involving such a large-scale forestry area failed to comply with standard industry practice." Song Li further explained that the description "broad-leaved tree" is too vague and refers to multiple species.

No Plantation Rights Certificates

[366] Sino-Forest's BVI standing timber purchase contracts state that plantation rights certificates are attached. However, none of the purchase contracts attached a plantation rights certificate and, as of June 2, 2011, Sino-Forest did not have any plantation rights certificates available for any of its BVI standing timber holdings. Xu Ni, Sino-Forest's legal officer, reported that Sino-Forest's Suppliers did not have copies of plantation rights certificates either.

[4] A "mu" is a unit of land measurement in China. Fifteen mu is approximately equal to one hectare.

[367] Mr. Chan's own forestry expert, Gavin Hao, testified that the plantation rights certificate is the key document that allows a purchaser to prove that it owns the trees. The plaintiff's PRC legal expert, Qin Tianbao, agreed that "[t]he plantation rights certificate is proof of the ownership relationship of plantation rights."

[368] Of all the experts, only the defendant's Chinese resource law expert, Wang Jin, thought that plantation rights certificates were not required.

[369] The plaintiff's PRC legal and forestry experts stated that a purchaser would face enormous risk by concluding a plantation rights purchase without a plantation rights certificate. Mr. Chan's PRC forestry expert, Hao, similarly testified that he would always advise clients to inspect the plantation rights certificate before purchasing trees because otherwise they would not know if they owned the trees that they were supposedly buying. The plaintiff's PRC forestry expert, Song Li, testified that he has never encountered a situation where a company purchased forestry assets without obtaining a plantation rights certificate.

[370] New-form plantation rights certificates, as introduced in 2000, have four boxes representing the four different types of plantation rights: land ownership; land use; timber ownership; and timber use. Mr. Chan testified that the Sino-Forest BVIs did not have plantation rights certificates because the BVIs were not allowed to have land use rights and, according to Mr. Chan, plantation rights certificates were only issued for land use rights and not standing timber rights alone. However, Sino-Forest's records contained a plantation rights certificate for timber ownership and timber rights (but not land ownership or land use rights). Hao also testified that in his personal experience purchasing standing timber without the underlying land use rights, he was always able to get plantation rights certificate for the standing timber alone.

[371] The defendant's forestry law expert, Prof. Wang, questioned whether the plantation rights certificate regime instituted by the State Forestry Administration ("SFA") in 2000 and re-affirmed in 2004 was lawfully authorized by the central government. He admitted, however, in cross-examination that no PRC court or other authoritative body had ever issued such a declaration or any other finding or conclusion to this effect.

[372] There is a conflict between the evidence of Prof. Qin (who was called by the plaintiff) and Prof. Wang about whether the applicable laws in 2000 and following authorized plantation rights certificates only for rights over forest "land" or whether they also included rights to standing timber without land use rights. Prof. Wang says there were conflicting laws and that the laws prescribing certificates for forest land were the superior, governing laws. Prof. Qin says the laws were not in conflict – they are just focused on different aspects of land use – and that, in any event, the specific excludes the general, so that the laws specific to forestry, providing for separate certificates for both forestry land and standing timber, prevail over more general land laws containing rights over forest lands only.

[373] To the extent there is a conflict in their evidence, I prefer the evidence of Prof. Qin. My principal reasons for this conclusion are as follows. First, Prof. Qin's opinion on the law was

supported by and consistent with both the plaintiff's and the defendant's experts on forestry practice.

[374] Second, I accept Prof. Qin's assertion that, as a practical matter at least, the specific forestry laws promulgated by the SFA in 2000 (creating a national plantation rights certificate regime including certificates for both land and standing timber) prevailed over the provisions of more generic land use laws. And, as Prof. Qin said, even if one thought the SFA forestry law was *ultra vires*, a prudent purchaser would still comply with it until its status had been resolved.

[375] Third, while opining that the governing law defined certificates only in terms of forest *land*, Prof. Wang did not dispute, as a practical matter, that local forestry bureaus, applying the forestry law promulgated by the SFA, issued plantation rights certificates for standing timber. Indeed, Prof. Wang agreed that the implementation of the SFA's 2000 national plantation rights certificate regime was quite successful: by 2009, 51% of forest land was covered by plantation rights certificates, by 2010 over 82%, by 2011 over 86%, and by 2013 almost 98%. Rather, Prof. Wang's point was that implementation in the early years was chaotic and uneven, and took time. Funds were not necessarily made available at the local level to bring about full implementation of the plantation rights certificate regime. A lot was left to local forestry bureaus. The forestry bureau confirmations obtained by Sino-Forest in this case, he said, were a valid and common alternative.

[376] Fourth, Prof. Qin points out that Prof. Wang's statistics only reflect the new-form plantation rights certificate regime enacted in 2000. But there were prior forms of certificates of ownership available. Sino-Forest's external legal advisors at the time adverted to these as valid proof of ownership. Prof. Qin testified that if the pre-reform certificates are included in the statistics, as early as 1998 certificates had been issued for 78.9% of collective forest land nationwide; by the end of 2000 for 86%; and, by the end of 2003 for 90%. Prof. Qin testified that even if new-form plantation rights certificates were not available initially, a "considerable portion" of Sino-Forest's transactions should have been conducted with one of the pre-reform certificates. Sino-Forest had no pre-reform certificates of ownership either.

[377] Fifth, I found Prof. Wang's evidence both esoteric and internally inconsistent on the issue of plantation rights certificates. Prof. Wang doggedly adhered to his theory of the hierarchy of laws which, according to him, rendered the SFA forestry law invalid while at the same time acknowledging that no court or authoritative body ever made a declaration or other ruling to this effect and that the new form plantation rights certificate regime was robustly implemented throughout the PRC. It was internally inconsistent for essentially the same reason – although maintaining that the new-form plantation rights certificate was not lawfully authorized, Prof. Wang admitted it was implemented with increasing penetration across all forested areas in the PRC. In fact, nowhere does Prof. Wang ever say, as was maintained by Mr. Chan, that local forestry bureaus would not issue a plantation rights certificate in respect of standing timber unless the transferee of the standing timber rights was taking an assignment of the forest land use rights as well.

[378] The suggestion that Sino-Forest BVIs could not get plantation rights certificates from local forestry bureaus because the Sino-Forest BVIs were not acquiring any land use rights appears to have originated with the defendant and Inside Management following the Muddy Waters Report. Although, at the time, the IC seems to have accepted this proposition, the evidentiary basis upon which it did so is not clear. The need for acquisition of land use rights as a precondition to the issuance of a plantation rights certificate for standing timber was certainly not proved on the evidence in this trial. On the available evidence, I must reject the suggestion that plantation rights certificates were only available from local forestry bureaus in circumstances where Sino-Forest was acquiring land use rights. No expert said this was the case. And, the evidence is that the same forestry bureau that issued Sino-Forest's confirmation in the sample transaction (saying the bureau was not in a position to issue a certificate yet but would do so as soon as it had the certificate regime up and running) had, over a year earlier, issued a new-form plantation rights certificate for standing timber alone.

[379] Most importantly, the suggestion that Sino-Forest could not get a plantation rights certificate because it was not acquiring an interest in land is completely at odds with the language of the forestry bureau confirmations themselves. The confirmations say that the only reason the certificate is not being issued is because the local bureau had "not yet implemented the registration of the change in relevant timber ownership." They do not say that the bureau could not issue a certificate because Sino-Forest was not acquiring any interest in land.

[380] I accept the evidence of Mr. Chan's forestry expert and the plaintiff's experts on Chinese forestry practice and forestry law. I largely reject the evidence of Prof. Wang. He had no explanation, given his evidence that plantation rights certificates were increasingly pervasive throughout the PRC, for why, although every forestry bureau from which Sino-Forest obtained a confirmation promised to deliver a plantation rights certificate once the certificate regime was in place, not one of them ever did so. He similarly did not explain why Sino-Forest had no pre-reform certificates.

[381] The defendant also argues that the absence of plantation rights certificates cannot be evidence of a fraud because the absence of certificates was known to Sino-Forest's auditors and to Sino-Forest's Board. He points to a 2007 auditor's letter to management considered at a May 2008 Audit Committee meeting of the Board. The auditor's letter alludes to the situation that Sino-Forest was "still in the process of applying for plantation ownership certificates on some of the new plantations but the certificate approval process takes a considerable amount of time." The defendant also points to his counsel's cross-examination of Ardell and Hyde to support this proposition.

[382] The evidence does not support Mr. Chan's contention.

[383] Ardell's evidence does not touch on the issue of how much of Sino-Forest's BVI standing timber was supported by a plantation rights certificate. And Hyde's evidence was given only in the context of: a) when he joined the board in 2004; and b) the Audit Committee's review the auditor's letter to management in 2007.

[384] The auditor's 2007 letter to management is hardly an acknowledgement that Sino-Forest had no plantation rights certificates for any of its BVI standing timber. All it says is that the application process is still pending for "some" of the new plantations. I am prepared to accept that the implementation of the 2000 certificate reforms was still uneven, perhaps even chaotic, in 2007. But in 2007, Sino-Forest's BVI standing timber assets were a good deal smaller than they were in June 2011. And, by 2011, the evidence is clear that 86% of all forested land in the PRC was covered by issued plantation rights certificates.

[385] There is no evidence that, in 2010 or 2011, the Board or any of its committees, or Sino-Forest's auditors, were aware that, although plantation rights certificates had been issued in respect of 82% to 86% of all China's forested land, not one hectare of Sino-Forest's 520,000 ha of BVI standing timber was supported by a plantation rights certificate while essentially all of Sino-Forest's WFOE planted plantations were covered by plantation rights certificates.

No Villagers' Authorizations

[386] Sino-Forest's purchase contracts also all stated that they attached villagers' authorizations. However, no villagers' authorization was attached to any of the contracts. The report attached to Xu Ni's affirmation filed as part of the defence evidence claimed that Sino-Forest only reviewed the Suppliers' villagers' authorization "on a random basis."

[387] The plaintiff's PRC legal expert explained that "[a]ll forest resources growing on collectively owned forest land, including standing timber, are owned by the collective and rights of ownership are exercised by the collective … A Villagers' Authorization is documentary proof that a change in ownership has received the collective organization's consent."

[388] The plaintiff's PRC forestry expert similarly explained that a "Villagers' Authorization is a legal requirement with respect to transactions involving collectively owned forest assets and is also standard industry practice" and that not obtaining a villagers' authorization "will pose enormous risks."

[389] Hao, the defendant's forestry expert, agreed that without a planation rights certificate or a villagers' authorization, there would be no way of proving ownership of the standing timber assets and that there could be real problems when a company wishing to assert harvesting rights without a villagers' authorization went to harvest the trees.

[390] Again, Prof. Wang was the outlier on this issue. Prof. Wang claimed there was no legal requirement for a two thirds majority approval from a village or local collective. That may be, but it misses the point. Every BVI standing timber purchase contract entered into by Sino-Forest contemplated a villagers' authorization. It was, therefore, in practical terms at least, a protection available to Sino-Forest and stated to be included in every contract. Yet, no contract attached a villagers' authorization.

The Verification Reports Were Too Vague to Identify the Location of the Trees

[391] Sino-Forest's BVI standing timber purchase contracts stated that they attached survey reports. However, the documents that were attached were not survey reports but "verification reports," which have different specifications. Mr. Borrelli attached every verification report from August 24, 2003 until the end of December 2011 to his affidavit and attached one translated example verification report (associated with the sample purchase agreement) as representative of the others.

[392] The plaintiff's PRC legal expert concluded that the sample verification report "did not follow proper procedures for initiating a verification, the technical specifications on which it was based do not conform to relevant requirements; the report failed to disclose relevant information about the standing timber in a complete and detailed manner; and the report lacked a 'Forest Resource Asset Appraisal Report."

[393] The plaintiff's PRC forestry expert, Song Li, concluded that the sample verification report did "not comply with relevant regulations and standard industry practice." Song Li testified that, based on the information in the sample verification report, "it would not be possible to find the trees" because the asset list should identify the village, compartments, and sub-compartments. However, the asset list in the sample verification report only contained the town, not the village. Mr. Chan's PRC forestry expert, Hao, agreed that the sample verification report was "too general" because it only had the town but not the village and the reader of the report needs to know the village in order to find the trees.

[394] During Song Li's cross-examination, Mr. Chan's counsel asked him about one other verification report that appeared to contain the village, town, compartment, and sub-compartment. Song Li testified that he would be able to locate that particular plantation with that verification report *if* he also had a map. There was no map.

[395] Mr. Chan's counsel did not provide a translated version of that or any other verification report. The verification report was taken from Annexure 8 to the Borrelli Affidavit, which references the 525 BVI standing timber purchase contracts and attached verification reports that Sino-Forest entered into between August 2003 and June 2011. I was advised in argument that, of those 525 verification reports, only 30 (5.7%) contain the village, town, compartment, and sub-compartment and there were no maps associated with any of them.

[396] There are also related party concerns regarding the company that prepared most of the verification reports. Most of the verification reports were prepared by a company called Zhanjiang Southern. The IC and its advisors reported that Zhanjiang Southern was 10% owned by Lu Qiding and 80% owned by Qi Shuxiong. Lu Qiding was a former Vice President of a Sino-Forest subsidiary and worked for Sino-Forest from 1999 to 2010. The IC reported that Qi Shuxiong acted as a consultant to Sino-Forest subsidiary from 1993 to 2001 and received a fee of RMB 3,000 per month during that period. The IC advisors discovered that Qi Shuxiong was a

director of two Sino-Forest subsidiaries until 2003 and a supervisor of a Sino-Forest subsidiary from 1993 to 2006.

[397] The IC reports were admitted into evidence without objection. Both parties rely on various findings or conclusions embedded in these reports. The evidence establishes that the IC discovered this information and had these concerns. It does not necessarily prove the information to be true, although the defendant adduced no evidence to contradict this information. It is, at the very least, an insight into the quality of the information that was being obtained at the time by the IC and its advisors.

The Forestry Bureau Confirmations Were Insufficient to Establish Title

[398] Rather than obtaining plantation rights certificates and villagers' authorizations, Sino-Forest obtained forestry bureau confirmations for the majority of its BVI standing timber purchases. These confirmations were all in substantially the same form.

[399] Qin Tianbao, the plaintiff's PRC legal expert, testified that "[o]ther documents, including the confirmation from the Forestry Bureau, do not constitute a legal basis for the transferee to obtain ownership rights to the collectively owned standing timber." The plaintiff's PRC forestry expert similarly testified that confirmations "do not replace the plantations rights certificate." They both agreed that there would be enormous legal risk by concluding a standing timber plantation transaction in the absence of a plantation rights certificate. Hao agreed that all the confirmation did was contain the forestry bureau's promise that the bureau would issue a plantation rights certificate when the system was up and running. As no plantation rights certificates were ever issued, the confirmations were useless.

[400] The Hong Kong Stock Exchange refused to list Sino-Forest in 2003 because, as Xu Ni testified, the Hong Kong Stock Exchange "did not believe that the confirmations were the same as Plantation Rights Certificate and therefore it was not sufficient … the Hong Kong Exchange would only give considerations to the Plantation Rights Certificate and no other proof."

[401] During the IC investigation, the IC sought to contact forestry bureaus to verify the confirmations directly. The IC and its advisors asked Mr. Chan and management for contact details for the forestry bureau officials to be visited. However, Mr. Chan and senior management were very reluctant to allow the IC advisors to interview forestry bureau representatives and refused to provide the contact details; instead, management arranged the meetings themselves.

[402] Serious concerns arose from the forestry bureau meetings, which took place between July and November 2011. For example, with respect to the Dongkou Country Forestry Bureau, the IC reported that:

> The visit was conducted at the forestry bureau and attended by one person who Management introduced as a vice chief of the forestry bureau. Subsequent to the meeting, it was found that the individual had been removed from this position and his name was not listed on the official forestry bureau website. Further, the IC

> Advisors also obtained verbal confirmation over a direct telephone inquiry to the forestry bureau that the person they had met no longer held the position of vice chief.

[403] It was also discovered that "the former vice chief was previously a consultant with SF who received monthly payment from SF" and that "[h]e mentioned that the decision of issuing confirmations was made by the previous chief, who had been arrested due to corruption charges, and the forestry bureau had not issued confirmations to other companies." The IC further reported that "[t]here are indications in emails and in interviews with Suppliers that gifts or cash payments are made to forestry bureaus and forestry bureau officials."

[404] This evidence from the IC report was, again, not independently proved during the trial. In the circumstances, I make no finding on whether the specific content of the reported information was true. The report does provide insight into the quality of the information being received, and the concerns being raised, by the IC and its advisors at the time.

[405] Of more direct significance is that Mr. Chan and Inside Management at the time expressed "strong concerns" about approaching the forestry bureaus to confirm or reconfirm existing forestry bureau confirmations. Management claimed, among other things, that the confirmations were "confidential" and "could embarrass the forestry bureau officials."

[406] While this alone raises significant questions regarding the legitimacy of the original confirmations, it also forced the IC advisors to seek to have the forestry bureaus issue new confirmations to help validate Sino-Forest's purported ownership rights to its claimed standing timber holdings. The IC advisors reported that new confirmations were only obtained in four instances and that:

> In all four instances where new confirmations were obtained, the forestry bureau or other parties who issued the confirmation did not sign the new form of confirmation as sought by the IC Advisors but instead prepared their own versions whereby ownership is not confirmed and only a contractual arrangement between SF and its Supplier is recognized.

[407] The only expert who placed a great deal of importance on the forestry bureau confirmations was the defendant's PRC legal expert, Prof. Wang, who went so far as to testify that "it's impossible to have legal risk" if forestry bureau confirmations were obtained. However, during cross-examination, Prof. Wang admitted:

> Q. Okay. And just so we're clear on this, if a forestry bureau issued a confirmation, you would expect the forestry bureau to stand behind the confirmation and validate it; isn't that right?
>
> A. Correct.
>
> …

> Q. I'm just asking you, if Sino-Forest went to the forestry bureau and said, "Help us resolve this dispute," you wouldn't expect that request to jeopardize Sino-Forest's relationship with the forestry bureaus, would you?
>
> A. I don't think so.
>
> Q. No. And similarly, you wouldn't expect the forestry bureaus to say that they would be embarrassed if a request was made for them to confirm the confirmations that they issued.
>
> A. Right.
>
> Q. And you also wouldn't expect the forestry bureaus to be saying that they may have exceeded their authority in issuing the confirmations, would you?
>
> A. Right.
>
> Q. Nor would you expect the bureau to say that the confirmations were confidential and if they were presented, the bureau would deny issuing them, would you?
>
> A. The confirmations have already been issued to the parties involved, so it seems that your question is problematic. How can the confirmations be confidential?
>
> Q. Exactly, and if properly issued by the forestry bureaus, there would be no reason why the bureaus would deny having issued them, is there?
>
> A. Correct.
>
> Q. And similarly, you would not expect the forestry bureaus to say that the confirmations contradict the position of the Chinese Central Government, would you?
>
> A. Correct.
>
> Q. And, in fact, if these were legitimately issued certificates, you wouldn't expect any of that to happen; isn't that right?
>
> A. Correct.

[408] All of these representations, however, were made by Mr. Chan and other member of senior management to the IC advisors in 2011. Senior management expressed strong concerns to the IC advisors about approaching the forestry bureaus to reconfirm existing confirmations. Prof. Wang agreed that each of these representations made by Sino-Forest management was inconsistent with the forestry bureau confirmations being legitimate documents. If the forestry bureau confirmations were legitimate documents proving ownership, why would senior management not

want anyone else approaching the local forestry bureaus? And why would the forestry bureaus not, immediately upon request, confirm that they were legitimate documents and reissue them to Sino-Forest as the IC advisors requested?

[409] Thus, if Prof. Wang's opinion was correct, Mr. Chan and senior management would not have sought to discourage the IC and its advisors from approaching the forestry bureaus and the forestry bureaus ought readily to have reissued or confirmed their prior confirmations. Senior management's response to the IC's request and the forestry bureaus' responses significantly undermine Prof. Wang's opinion and constitute strong evidence that the forestry bureau confirmations were not *bona fide* and did not in actual fact constitute any evidence of ownership.

[410] In addition, the IC discovered during its investigation that Sino-Forest personnel "prepared the actual forestry bureau confirmations on notional forestry bureau letterhead on which a forestry bureau chop was then obtained." No individual at any forestry bureau is ever named or identified. The Litigation Trust confirmed that forestry bureau confirmations (along with purchase and sale contracts and other documents, as set out below) were created by Sino-Forest personnel following the end of each quarter under Hung's direction.

[411] During Hung's evidence, he explained that Kenny Wong (who also prepared all the contracts and other documents at the end of each quarter) prepared the forestry bureau confirmations at the same time, and backdated them to the date of the underlying contract.

[412] Mr. Borelli's affidavit attaches a translation of a representative forestry bureau confirmation, which was issued by the Gengma Dai and Va Autonomous County Forestry Bureau in connection with the sample purchase agreement. It states, among other things, that the bureau is temporarily unable to process the change of registration of ownership because it has not yet implemented the system for issuing new plantation rights certificates, but that it will do so later when the system is up and running.

[413] This confirmation, indicating that the Gengma County forestry bureau will issue a plantation rights certificate once the new ownership system is in place, is dated September 23, 2008. However, Sino-Forest had in its records a plantation rights certificate for standing timber rights alone issued by the same forestry bureau more than one year earlier, on May 25, 2007. Accordingly, the statement in the September 23, 2008 confirmation, that the Gengma County forestry bureau was unable to process a plantation rights certificate because it had not put in place the new registration system, was incorrect. Hao, the defendant's forestry expert, therefore found the forestry bureau confirmation to be "surprising." In fact, no forestry bureau has ever issued a plantation rights certificate to a Sino-Forest BVI subsidiary, despite promising to do so in 525 confirmations. Hao also found this "surprising."

[414] Sino-Forest obtained identical confirmations which made identical representations from 66 different forestry bureaus in nine provinces for 525 standing timber purchase contracts over a six year period. I agree with the plaintiff; it is completely implausible that so many government bodies with different levels of progress in forestry reform and different local rules and regulations

would issue confirmations over that period of time without any change to the language and without ever issuing a promised plantation rights certificate at a later date.

[415] This is especially so because, even though Prof. Wang doubted the legality of the plantation rights certificate regime and said its implementation was underfunded and uneven throughout China, his own research demonstrated a high level of successful implementation of the new-form plantation rights certificate in the period relevant to this case - 2009 to 2011 (and beyond). As noted earlier, at p. 44, para. 49 of his report, Professor Wang set out that:

- by 2009, just over 50% of the relevant forest areas had new form plantation rights certificates issued

- by 2010, the number had increased over 82%

- by 2011, over 86% of forest land had issued new form plantation rights certificates, and

- by 2013, almost 98% of forest land was subject to the new form plantation rights certificates.

[416] Hao, the defendant's forestry expert, cited almost identical figures in his evidence in chief. It is implausible, given these levels of implementation, that no forestry bureau ever issued a promised plantation rights certificate from 2009 to 2011 (or still to this day).

[417] Subsequent events also make it clear that the forestry bureau confirmations do not have the value Mr. Chan has ascribed to them in this proceeding. I say this because, if Mr. Chan was right, Sino-Forest would have been able to demonstrate that it owned its BVI standing timber holdings long ago and the market would have been willing to pay for Sino-Forest's BVI standing timber assets either during the two sales processes supervised by the court, or, following the Emerald sale to New Plantations in 2016.

Shortcomings in the BVI Model Sales Contracts and Underlying Documents

The Contracts Were Too Vague to Find the Standing Timber Assets

[418] Similar to the BVI standing timber purchase contracts, Sino-Forest's sales contracts with the AIs were also too vague to locate the standing timber that Sino-Forest was selling. The translated sample Sales Agreement is substantially similar to all other BVI standing timber sales agreements. It says that the Sino-Forest BVI was selling "broad-leaved tree standing timber occupying an area of 5,939.00 mu in Yunnan Province." It does not refer to a village or town. During cross-examination, Hao agreed that Yunnan is much bigger than Germany; the contract told the purchaser, therefore, that Sino-Forest was selling the AI a 400 hectare plantation of trees located somewhere in an area the size of Germany.

[419] This problem was complicated by the fact that, although Sino-Forest bought large plantations from its Suppliers, it sold them off two or three years later in numerous, smaller plots to multiple purchasers. In the sample purchase transaction, the Sino-Forest BVI bought from Yuda Wood 52,426 mu of standing timber in Gengma County, Yunnan Province in September 2008. In February and March 2011, over a period of seven weeks the Sino-Forest BVI partitioned that plantation off in nine separate sales contracts with four different AI counterparties. The sample sales contract is with Shanghai Liangze Trading Company for 5,939 mu, but there are eight other sales contracts, some with other purchasers, accounting for the rest of the 52,426 mu. How did each purchaser know which plot of trees it was purchasing?

[420] Mr. Chan, who signed all of these contracts, gave evolving evidence about this problem. He first said on his examination for discovery that he did not know what information was given to the AIs to identify the trees. Later, at trial, he testified to his understanding that Sino-Forest gave the AIs the purchase contract and verification report. He said he learned that later, during the New Plantation deal with Emerald. Then, in cross-examination, Mr. Chan said if the customer could not find which trees they had bought, they would get help from the forestry bureau. When pressed on how the forestry bureau could assist with this problem, he then said the AI purchaser could also get help from the surveyor if they needed it.

[421] In the end, Mr. Chan was driven to say that the four buyers of the nine plots of trees in Yunnan Province could get together and agree, amongst themselves, which portions of the original 52,426 mu plantation was theirs.

[422] This situation exposes a critical flaw in the logic of Mr. Chan’s claim that these were *bona fide* arm’s-length deals with real customers selling real trees. How could any of these purchasers know what part of Sino-Forest’s 52,426 mu plantation it had purchased? How could a purchaser ever harvest any trees if it could not identify which plot of trees were the trees it owned and was entitled to harvest? Mr. Chan had no explanation for this other than to throw up his hands and say the purchasers could figure it out.

[423] Given the enormous scope for future problems for the purchasers due to uncertainty on such an important issue, it is simply incredible that any buyer would conclude a deal under these circumstances. But not only were hundreds of these transactions concluded, the buyers paid (earlier than necessary on average) 100% of the time. It is also incredible that there is no record of any AI or ultimate purchaser ever having a problem reselling or harvesting the trees, or complaining to Sino-Forest or having to sort out, with other purchasers of the other subsections of original Sino-Forest acquisitions, who owned what.

[424] This is, I conclude on the preponderance of probabilities arising from the evidence, strong evidence that the transactions were not real. There were no problems because there were no purchasers of trees that anyone ever planned to cut down. It is further evidence that the transactions were a sham.

No Underlying Documents

[425] Unlike the BVI standing timber purchase contracts, the sales contracts did not have any attachments. However, under the terms of the sales contracts, the Sino-Forest BVI agreed to provide the purchaser "with copies of the documents relating to the standing timber under this Agreement as reference materials for the entrusted sale." There is no evidence that any AI ever asked for these "reference materials."

[426] As noted above, during cross-examination Mr. Chan stated that "we provide them a copy of the purchase contract." However on his examination-for-discovery, Mr. Chan testified that he had no knowledge of what documents the Sino-Forest BVIs agreed to provide and that he did not believe that he ever asked anybody.

No Harvesting Permits

[427] Under the sales contracts the Sino-Forest BVI also undertook to apply for licences and permits such as felling licenses and transport permits for the AI, and would provide the AI with other "necessary assistance."

[428] The plaintiff's forestry law expert, Prof. Qin, gave evidence that the lack of a plantation rights certificate affects the ability to obtain a felling licence. Mr. Chan's own PRC forestry expert, Hao, previously authored a report stating that, without the plantation rights certificate, "a forest owner normally cannot obtain a harvest permit." Hao agreed during cross-examination that a forestry company needs a plantation rights certificate to be able to obtain a felling permit in the PRC. Even Mr. Chan agreed that "you can't get a harvesting or felling license without a plantation rights certificate."

[429] Since Sino-Forest did not have plantation rights certificates for its BVI standing timber plantations, it could not have obtained the felling licenses it promised the AIs it would obtain.

[430] During cross-examination, Mr. Chan said it was his understanding that, as required by the contract, the Sino-Forest BVIs assisted the AIs in applying for the permits. Mr. Chan was again impeached by previous evidence given on discovery when he testified that "the buyer will take care of it themselves ... The buyers, they will do it." When confronted with the conflicting testimony, Mr. Chan told a third story - Sino-Forest would go to the *Suppliers* for help as the Suppliers had the plantation rights certificates. However, that could not be the case because, according to Xu Ni's evidence, Sino-Forest's Suppliers did not have plantation rights certificates either.

[431] Mr. Chan's inconsistent evidence on this important point highlights again how little commercial sense the BVI standing timber model made for any of the parties, given that the end purchaser (the AI or another purchaser who bought from the AI) could never cut down the trees; critical documentation was simply not available. True arm's-length third parties would not buy timber plantations if they had no right to harvest the trees.

[432] Despite the fact that neither Sino-Forest nor its customers could have obtained the felling permits, neither Mr. Chan nor Hung were aware of any AIs or end-customers ever complaining that they could not harvest the trees that they had purportedly purchased or seeking assistance from Sino-Forest or its subsidiaries in obtaining felling licences.

Perfect Accounts Receivable and Early Payment *Versus* No Collection

[433] Even though the AIs and customers lacked the necessary documentation to prove they had the right to harvest the trees they had purchased, Sino-Forest's records show that it had perfect accounts receivable collections from its sales of BVI standing timber prior to the release of the Muddy Waters Report. The books of the company report that every AI paid every dollar owed to Sino-Forest. Not only did they pay in full, but the AIs paid, on average, over four months before the payments were actually due under the sales contracts. This is not normal commercial practice.

[434] In spite of this history and despite its best efforts, the Monitor was unable to collect any of the $887 million in outstanding BVI standing timber receivables that were on Sino-Forest's books at the time of its CCAA filing. The 100% collection rate became a 0% collection rate once there was a Court officer in place to test the validity of the transactions.

[435] As noted earlier, the Monitor could not track down any of the AIs to collect payment. Engen testified that, "[u]nfortunately, we had nobody to talk to about how it [the outstanding receivable] could be paid."

Contracts and Other Documents Were Created After the End of Each Quarter

[436] As noted earlier, the IC discovered that following the end of each quarter, Hung instructed a subordinate, Kenny Wong, to prepare BVI model purchase contracts, forestry bureau confirmations, plantation purchase requisition forms, and sales agreements for all the transactions that had taken place during the preceding quarter. Kenny Wong prepared the documents using a "mail merge" function on his computer that allowed him to produce a set of documents for each transaction with the push of a button.

[437] Hung testified that Kenny Wong was able to do this by merging the standard form contract documents with an Excel spreadsheet which Hung continually updated throughout the quarter. Hung said that Ip would call him each time there was a new standing timber deal. Hung scribbled the details onto post-it notes, he said, and then later, when he had time, entered the contract particulars onto the spreadsheet.

[438] The purchase contracts stated that the parties "have signed this contract on" a date earlier in the quarter. This was untrue - the contracts were created and signed following quarter-end. The forestry bureau confirmations were also backdated to the date of the underlying contract. The sales contracts similarly stated that the parties "have signed this Agreement on" a date within the quarter, which was also untrue because they too were produced following the end of each quarter.

[439] In connection with each BVI standing timber sale, Sino-Forest employees would also create documents containing instructions and confirmations pertaining to the set-off payments. The set-off documents included: (a) a letter from Sino-Forest to the Supplier that a payment would be made to the Supplier by the AI; (b) a letter from Sino-Forest to the AI instructing it to make the set-off payment; (c) a letter from the AI advising Sino-Forest that it made the payment; and (d) a letter from the Supplier to Sino-Forest confirming that the Supplier received the payment. Even though the letters from the AIs and Suppliers were on their letterhead and appear as though they were created by the AIs and Suppliers, they were actually created by Kenny Wong following the end of each quarter.

[440] There is no evidence that these documents were ever actually sent from Sino-Forest to the Suppliers or AIs. There is also no evidence, in the form of cheques, accounts or bank withdrawals or deposits, that any payments between AIs and Suppliers were ever actually made.

[441] It is also important to know that the setoffs did not relate to the purchase and sale of the same standing timber plantation and were by no means as simple as just described. In many cases, Sino-Forest counterparties did not themselves make or receive the payment. Suppliers frequently directed payment not to themselves but to other parties once removed, or twice or three times removed, from these transactions. Likewise, AIs often did not make the purported payments themselves but caused them to be made by parties not in any contractual relationship with Sino-Forest at all who were twice, three times, or even further removed from Sino-Forest and the AI. This made any tracing or confirmation of actual payments virtually impossible.

BVI Model Counterparties Provided No Supporting Documentation During the IC Investigation

[442] Mr. Chan claimed to have relationships with the Suppliers and AIs. During its investigation, the IC and its advisors asked Mr. Chan to facilitate meetings with the Suppliers and AIs at which meaningful information would be made available. This process was significantly delayed by lack of cooperation from Mr. Chan and Inside Management. However, even when the IC advisors did finally manage to set up meetings with a few AIs and Suppliers in September and October 2011, Mr. Chan and Inside Management declined to attend those meetings in spite of the IC advisors' express requests that they do so.

[443] Under the BVI standing timber model, the Suppliers and AIs conducted extraordinary volumes of business with Sino-Forest. Given the volume of lucrative business they were conducting with Sino-Forest, it is reasonable to expect they would have done everything possible to assist in demonstrating that their transactions with Sino-Forest were real; doing so would have preserved a significant source of business for them. In fact, the exact opposite proved to be true.

[444] In every case, the Suppliers and AIs declined to show any financial records that would demonstrate the validity of the BVI standing timber transactions. The excuses provided included a desire to avoid scrutiny regarding tax, media exposure, and that Sino-Forest should have copies of the same documents. The limited documents that were provided by some interviewees were

not the documents requested and did not relate to any of the transactions that the IC sought to confirm.

[445] The excuses provided by the Suppliers and AIs do not stand up to scrutiny. With respect to tax, Suppliers and AIs readily acknowledged the transactions had occurred, so providing evidence of these same transactions could not reasonably have created any tax problems. The same is true regarding media exposure - there could be no more exposure from providing documents to confirm transactions they readily admitted had taken place. In any event, confidentiality measures were put in place. The IC reports even redacted the names of the AIs and Suppliers. And, if Sino-Forest had copies of the same documents already, there is no reason for the AIs and Suppliers to be reticent to provide them.

[446] Not one Supplier nor one AI provided a single plantation rights certificate, villagers' authorization, or financial record validating or verifying the purported BVI standing timber transactions.

No Evidence of the Existence of Counterparties from Site Visits

[447] With one exception, none of the IC advisor meetings with AIs and Suppliers arranged through senior management took place at the business addresses of the AIs and Suppliers shown in Sino-Forest's records or at the registered addresses noted in their corporate filings.

[448] When the IC advisors made *unannounced* visits at offices or locations of record for AIs and Suppliers, they found no evidence of operations at any of those locations, except for one AI that had changed its name.

[449] The Monitor had a similar experience making unannounced site visits to Suppliers and AIs. The Monitor found little to no evidence of the existence of Sino-Forest's purported counterparties. Some of the locations were not specific enough to be found at all, others turned out to be forestry bureau offices, others were incorrect (supposedly on the 18th floor of what turned out to be a three storey building) or were simply not occupied by the AIs or Suppliers. These entities had vanished.

Mr. Chan and Inside Management's Control of Contracting Parties

Yuda Wood

[450] During the period 2005 to June 2011, Yuda Wood was Sino-Forest's largest BVI standing timber Supplier, receiving 14% of the total consideration "paid" to all BVI standing timber Suppliers during that period.

[451] In August 2011, the IC advisors located a number of documents suggesting questionable relationships between Sino-Forest's senior management team and Yuda Wood. This information was not volunteered by Mr. Chan or senior management. The information was only discovered

through the investigations of the IC advisors, including their review of massive volumes of company records.

[452] Like many of Sino-Forest's purportedly arm's-length counterparties, Yuda Wood was owned and managed by former Sino-Forest employees. For example, Huang Ran worked at Sino-Forest from 1997 to 2007 and made a monthly salary of RMB 6,200 (approximately CAD$1,200) at the time he left. Huang Ran was the legal representative and executive director of Yuda Wood. Huang Ran is also listed as the manager of other BVI and WFOE standing timber Suppliers on the Nominee Company Managers List.

[453] Other former Sino-Forest employees were also involved in managing Yuda Wood and were the named shareholders of Yuda Wood's parent company, Sonic Jita.

[454] The IC uncovered documentary evidence that Ho managed Yuda Wood's bank account. Hyde emphasized during his examination-in-chief that:

> The item that stuck most significantly with me was that Sino-Forest, and specifically George Ho, was managing the bank account for Yuda Wood. Which was a rather surprising revelation, that this was supposed to be an arm's length Supplier, and I hadn't run into anything like that in my experience in the financial industry.

[455] May Liu, who worked for Ho, monitored Yuda Wood's bank accounts and asked for Ho's authorization regarding Yuda Wood payments (using non-Sino-Forest email accounts, including Eminens accounts). For example, in an email dated February 8, 2010 from May Liu to Ho, she said:

> Yuda has received the remittance of ¥4,516,000 from Yang Jun. This amount is for the payment of Gengma's 58,000 mu timber amount. Do you agree to the payment? Please provide your instruction!

[456] In an email from Ip to Ho, copied to Mr. Chan (again, using non-Sino-Forest email accounts), Ip said they had to help Yuda Wood pay its taxes because Huang Ran's account had no money.

[457] May Liu also sought Ho's approval when Ran requested more control over Yuda Wood's affairs. This indicates that Ho, Sino-Forest's CFO and VP Finance, had the authority to determine whether to give Ran more control over what was supposed to be Ran's company. In the same email, May Liu also noted that Yuda Wood did not have reasonable operating expenses compared to its revenues. This strongly suggests that Yuda Wood was a shell company with no real operations.

[458] During the IC investigation, Mr. Chan swore a statutory declaration in which he deposed that:

(a) he did not hold a direct, indirect or beneficial shareholding interest in Yuda Wood, Beijing Sonic Jita or Hong Kong Sonic Jita or their affiliates, and was not involved in their operations and did not have other personal arrangements with or entitlements from these entities; and

(b) to his knowledge, no officer, director or employee of Sino-Forest held a direct, indirect or beneficial shareholding interest in Yuda Wood, Beijing Sonic Jita or Hong Kong Sonic Jita or their affiliates or was involved in their operations, and that to his knowledge, no other officer, director or employee of Sino-Forest had any other personal arrangements with or entitlements from these entities.

[459] During Mr. Chan's interview with the IC advisors on August 24, 2011, he was shown an email, on a non-Sino-Forest server, from Simon Yeung, a member of Inside Management, to Mr. Chan's friend, Marco Lam, recommending that Lam borrow money in the name of Yuda Wood because Yuda Wood was "a wholly foreign owned enterprise, and its operation is 100% controlled by us." Mr. Chan was also shown another document in which Ip and Yeung discussed the capitalization of Yuda Wood. During the interview, Mr. Chan retreated from the blanket denials contained in his statutory declaration saying, "if I had seen these documents, I would have to investigate before signing. … I would have to ask for answers." At trial, Mr. Chan admitted that he has never asked for answers from Sino-Forest's senior management regarding these documents.

[460] Rather, Mr. Chan engaged in speculation, split hairs on possible translation issues and repeatedly refused to acknowledge that what Yeung was plainly saying could possibly imply that Yeung and senior management at Sino-Forest "100% controlled" Yuda Wood. I found Mr. Chan's responses to these documents, as with so many others, incredible. I do not accept Mr. Chan's evidence. I accept the evidence of the contemporaneous document, authored by one of Mr. Chan's chief lieutenants, viewed in the context of all of the other evidence, as meaning what it says: "us" means Mr. Chan and Inside Management; Yuda Wood was "100%" controlled by them.

Kun'an

[461] Kun'an was another major BVI standing timber Supplier.

[462] Kun'an appears on the Nominee Company Managers List with Huang Ran listed as the manager, Yu De Gang listed as a 60% shareholder and the director/legal representative, and Tian Jian Guo listed as the other shareholder. Similar to Yuda Wood, these individuals are all former Sino-Forest employees. For example, Yu De Gang left Sino-Forest on October 31, 2008. He was making a monthly salary of RMB 5,250 (approximately CAD$1,000) at the time.

[463] On January 7, 2009, within months of Yu De Gang leaving Sino-Forest, someone named Joe Chan sent an email to Yosanda addressed to "Allen" that set out a list of "lucky names" for a "Guangxi company." Mr. Chan testified that Joe Chan is a friend of his who is a "master in Feng

Shui." One of the names proposed by Joe Chan was "Kun'an." Kun'an was incorporated thirteen days later on January 20, 2009.

[464] During cross-examination, Mr. Chan initially testified that Huang Ran did not ask him to choose the company name. However, when confronted with his previous sworn evidence given during his examination for discovery - that Huang Ran did ask him to choose the name - Mr. Chan changed his evidence and testified that Huang Ran did ask him to choose the company name on behalf of Huang Ran's friend, Yu De Gang.

[465] On January 9, 2009 a Sino-Forest BVI named Amplemax Worldwide Ltd. entered into a contract with Kun'an for the purchase of 2,860 hectares of standing timber for RMB 60,515,400. This was 11 days before Kun'an was incorporated and two days after Mr. Chan received the Kun'an name from Joe Chan.

[466] Thus, a junior Sino-Forest employee making RMB 5,250 per month left Sino-Forest and, within a couple months, had a company, the name of which was chosen by Mr. Chan, which acquired 2,860 hectares of standing timber for RMB 60,515,400, and entered into a contract to sell those trees to Sino-Forest before the company was even incorporated. Mr. Chan thought this was unremarkable. He testified that "in China even a chauffeur can be a big boss … what I'm saying is that in China driver, junior guys, that can make a fortune, yes."

[467] In an email dated September 29, 2009, Yeung emailed Huang Ran, copying Ip and another individual named Wu Qianhui who worked for Ip, calling Huang Ran "the head of the pirates." Yeung told Ran that the Kun'an company "has to step up to the plate to make the cooperation with us perfect to reach the goal set by" Ip. Yeung told Ran to "urge Jun Yang" to take steps to make Kun'an "look like a company with a certain scale, not an empty shell company" such as "getting a business hotel room on a long term basis, there must be an office." Jun Yang was also a former Sino-Forest employee who left in October 2008 – the same time that Yu De Gang left.

[468] Yeung also directed that Jun Yang should "collect all of the contracts signed between Kun'an and Sino-Forest" and "prepare accounts receivables and payables; if there are accounts receivables, send collection letters in the name of Kun'an company."

[469] Yeung further stated in the September 29, 2009 email that "For big money account, it takes two stamps to withdraw money, one is Jun Yang's stamp, one is Hua Li's stamp from accounting." Hua Li was one of Mr. Chan's nominees on the Nominee Company Managers List. Yeung then stated that "For small money account, it also takes two stamps to withdraw money, one is Jun Yang's stamp, one is the stamp of cashier payable or president Wu." Wu was a Sino-Forest employee who worked under Ip. A Sino-Forest employee, therefore, was required to sign off on payments to be made by Kun'an.

[470] Yeung concluded this email by saying:

> In summary, Kun'an needs to be built like it were a new company, Jun Yang is the head of this task, and you are the head of Jun Yang. Move, you cannot wait

> anymore, otherwise, when the books are getting bigger and bigger, it will be a mess.

[471] By the time of the September 29, 2009 email, Kun'an had entered into at least 12 BVI standing timber purchase agreements with Sino-Forest subsidiaries for a total of 45,127 hectares with a total consideration of over RMB 1.2 billion.

[472] By way of contrast to this large and rapid growth, Hao, Mr. Chan's PRC forestry expert, testified that when he worked at a mature PRC forestry company called StoraEnso, it took 500 employees dealing with multiple suppliers seven years to acquire 90,000 hectares of trees. Yu De Gang and Jun Yang, minor clerks with Sino-Forest, were able to acquire and re-sell 45,127 hectares valued at over $1 billion RMB in less than one year through Kun'an, an "empty shell company," that Mr. Chan himself described as a "one-person, briefcase company."

[473] Apart from Kun'an, three of Sino-Forest's other BVI standing timber Suppliers also appear on the Nominee Company Managers List; they are Zhanjiang Bohu, Jiangxi Senchangtai and Yongzhou Maoxiang.

[474] The IC and the Monitor reported that they learned from Mr. Chan that some of the AIs had "backers." Mr. Chan recommended contacting these backers to collect outstanding receivables. The Monitor reported that Sino-Forest was unable to contact those backers. Mr. Chan testified during cross-examination at trial that he spoke to the backers and that the backers told him that no one tried to reach out to them during that period. When asked who the backers were, Mr. Chan answered that two of them were Lei Guangyu and Liu Feng. Both appear on the Nominee Company Managers List as two of Mr. Chan's nominees.

[475] Lei testified at the trial. He was asked during cross-examination if he was a backer of an AI. Lei responded by saying that, in respect of one AI, "I have only lent money two times or three times to them, and the amount is small." Lei said he had no control over that AI. When asked if he would be the right person to speak to about collecting a debt owed by that AI to Sino-Forest, he responded that "[t]here is no relationship with me at all."

[476] The concept of a "backer" was Mr. Chan's attempt to explain why it should not be surprising that former junior Sino-Forest employees like Huang Ran and Yu De Gang emerged overnight as timber barons. However, there is no independent evidence of these backers and the only alleged backer to testify, Lei, denied ever playing such a role.

[477] Sino-Forest earned significant profits buying and selling standing timber plantations. Because of the system of setoffs and directed payments, the Suppliers and AIs not only knew who each other were, they knew how much was paid by and to Sino-Forest for the standing timber plantations.

[478] Mr. Chan could not explain why the Suppliers and the AIs, knowing of each other, would not start doing deals directly, eliminating Sino-Forest as the middle man, and sharing some or all of the profit reaped by Sino-Forest between themselves.

[479] The defendant also says Muddy Waters made all this up. While it is possible that Muddy Waters could have published a false report to profit from its short position, I find that theory is not in accordance with the probabilities arising out of the evidence in this case.

[480] I say this because, if the Muddy Waters allegations were false, Sino-Forest ought to have been able to readily disprove the Muddy Waters allegations. As the plaintiff argued, real companies with real assets can prove that they own those assets. That is why it was relatively easy for Sino-Forest to prove it had the cash it was supposed to have, certain of the WFOE assets it was supposed to have, the shareholding in Greenheart it supposedly had, and certain of the manufacturing assets it was supposed to have.

[481] By contrast, Sino-Forest was manifestly unable to disprove the Muddy Waters allegations regarding the BVI standing timber assets. Mr. Chan still, after six years, provided no credible explanation of why the BVI standing timber assets have remained so elusive.

[482] Sino-Forest was unable to prove it owned $2.9 billion worth of BVI standing timber assets. The defendant's own forestry practice and resource law experts support this conclusion. Sino-Forest had hundreds of forestry bureau confirmations, from 66 different forestry bureaus in nine provinces, promising the delivery of a plantation rights certificate as soon the local bureaus had the new form certificate system in place. Prof. Wang and Gavin Hao both testified that by 2011, 86% of all forested areas in China had issued plantation rights certificates. By 2013, this figure had risen to almost 98%. Yet, not one of the 66 forestry bureaus has ever issued a plantation right certificate in respect of any BVI standing timber subject to those hundreds of forestry bureau confirmations.

[483] Sino-Forest was unable to prove that the Suppliers and AIs involved in the standing timber trading transactions were legitimate, arm's-length businesses who were paid, or paid, valuable consideration for the BVI standing timber. Following the publication of the Muddy Waters Report, these Suppliers and AIs essentially evaporated. The AI's had historically "paid" ahead of schedule 100% of the time. Collection on Sino-Forest's accounts receivable owing from AI's fell to zero upon publication of the Muddy Waters Report, leaving unpaid obligations owing to Sino-Forest of $887 million.

[484] The defendant argues that Sino-Forest's relationships were based on trust and that the Suppliers and AIs did not want to deal with the new people who took over Sino-Forest's daily operations – the IC and its advisors and, later, the court-appointed Monitor. A similar argument is also made to explain the unusually close connections between Sino-Forest and counterparties such as Yuda Wood and Kun'an.

[485] I am unable to accept this explanation. The Suppliers and AIs had been engaged in hundreds of millions of dollars' worth of trading with Sino-Forest. If these were legitimate businesses, there is absolutely no reason why they would not have wanted to continue their trading relationships with Sino-Forest. I do not accept that trust, or lack of trust, lay at the heart of this reluctance. Not only were the Suppliers and AIs not banging down Sino-Forest's door, they

completely disappeared. The defendant attempted to justify the unusually close connections with supposedly arms' length counterparties on the basis that oversight was necessary to make sure Sino-Forest's money was deployed by its counterparties appropriately. This seems to me to be the opposite of a relationship of mutual trust, not evidence of its existence. It is against this backdrop that the specific allegations against Mr. Chan and his senior management team must be assessed.

[486] In my view, the evidence supports the conclusion that Mr. Chan and Inside Management secretly controlled counterparties in many, if not all, of the BVI standing timber transactions.

High Profits with No Value Added

[487] The BVI model was cashless, meaning that Sino-Forest was not providing the capital outlay needed to acquire the standing timber assets. This is to be contrasted with wood log trading in which Sino-Forest paid large unsecured deposits to secure the supply of logs.

[488] Given that Sino-Forest did not have plantation rights certificates or villagers' authorizations, the transactions were risky for Sino-Forest's AIs. Sino-Forest also never obtained (nor was asked to obtain) the necessary harvesting or transportation licenses for its customers despite contracting to do so. Sino-Forest did not even pay taxes in the BVI model transactions, as the AIs were contractually obliged to do that.

[489] Because of the system of directed payments, the AIs were well aware of who Sino-Forest's Suppliers were, and the Suppliers were well aware of who Sino-Forest's AIs, or customers, were. Given that Sino-Forest did not finance these transactions, it is unclear exactly what Sino-Forest brought to the table. There has been no plausible reason advanced for why the AIs would, in the face of substantial margins being earned by Sino-Forest for simply buying and holding standing timber plantations for two to three years, not have contacted the Suppliers directly and avoided the middleman. Likewise, there has been no plausible explanation for why the Suppliers would not, at least over time, have dealt directly with the AIs, and increased their own margins.

[490] All Sino-Forest did under the BVI model was hold standing timber plantations for two to three years and then sell them at relatively high margins. In the sample transaction set out in the Borrelli Affidavit and Song Li's expert evidence, Sino-Forest purchased standing timber for RMB 3,224/mu and then sold it less than two and a half years later for RMB 10,829.52/mu - a threefold increase. Song Li described such a price differential as "extremely uncommon." BVI standing timber accounted for 50% of Sino-Forest's assets but over 95% of its profits. This must be contrasted with Sino-Forest's efforts, post-2004, under the WFOE model.

The BVI Model Versus the WFOE Model

[491] According to Mr. Chan, the BVI model was designed to circumvent restrictions on foreign companies carrying on business in the PRC. When the law changed in 2004 to permit WFOEs to purchase and sell standing timber, the BVI model was no longer necessary. Despite its undisputed limitations and obsolescence, however, the BVI model did not begin to fade away; instead, it reported ever-increasing growth between the years 2004 and 2011.

[492] If the BVI model was legitimate, there is no reason why Sino-Forest should not have been able to replicate this success in the WFOE model. However, the cash-based WFOE model, in contrast to the profits earned under the BVI model, actually incurred a net loss in 2011.

The Poyry Reports

[493] The defence has placed considerable reliance on the fact that Poyry conducted annual valuations of Sino-Forest standing timber plantations to support its contention that the BVI standing timber assets were legitimate.

[494] The Poyry reports were made available in both the CCAA and Emerald Plantations sales processes. Despite this, no buyer (including the ones that Mr. Chan himself advised) ever came forward with an offer to pay for the BVI standing timber assets. If the Poyry reports were good evidence of the legitimacy of the BVI standing timber assets, one might reasonably have expected someone in the industry to have acted on these reports during the two sales processes. No one did. There is no evidence that the Poyry BVI standing timber valuations formed any part of what New Plantations was willing to pay for the remaining Sino-Forest assets in 2016.

[495] Nor is there any evidence that New Plantations has been able to leverage these reports into any material value since April 2016.

[496] The Poyry reports were admitted into evidence on the consent of both parties. However, no witness from Poyry testified about these reports. They are contentious. The plaintiff is suing Poyry for professional negligence in connection with these reports. The defendant wishes to rely upon these reports as proof that Sino-Forest's BVI standing timber assets existed and that they were worth $2.9 billion.

[497] The reports themselves discuss the basis upon which they were prepared. The evidentiary value of these reports is, not surprisingly, significantly qualified by the terms of the reports themselves. For example, Poyry says under "Assumptions and Limiting Conditions" in its report of February 24, 2004 that:

(a) details concerning the location and physical characteristics of the forest assets were "taken from data provided by" Sino-Forest;

(b) Poyry has taken legal descriptions from sources thought to be authoritative but "neither assumes nor suggests responsibility for either";

(c) Poyry has undertaken a "limited visual inspection"; and

(d) legal matters are beyond the scope of the report.

This report goes on to note that stands of timber were measured using GPS or by manually interpreting detailed contour maps. Several stands were evaluated this way but the number of these evaluations was "limited by the time consuming nature of this operation."

[498] Later reports contain similar qualifications. In 2007, the Poyry valuation report added that it "had not reviewed any of the contracts relating to the forest land use rights or cutting rights or forest purchases."

[499] In 2008, the Poyry annual valuation report states that it relied on data supplied by Sino-Forest and that Poyry did not review any purchase contracts. In Appendix 4, the report says Sino-Forest provided hand-drawn maps and that from the information provided by Sino-Forest, Poyry drew a representative sample of 1,639 ha or .5% of Sino-Forest's forest estate. The report goes on to say, however, that of the 1,639 ha sample selected, only 301 ha represented purchased plantations whereas 1,338 ha involved planted plantations (which are not in issue in this action).

[500] The 2008 report also noted, for the first time, that its valuation methodology was "more challenging" in the case of Sino-Forest because it not only managed and harvested forests but actively traded standing timber assets. As a result, "the composition of Sino-Forest's estate can change quite significantly from one year to the next." Poyry's valuation methodology was based on a cash flow model which assumed Sino-Forest would hold the standing timber assets to maturity and harvest them. This, of course, was not the BVI standing timber model.

[501] In 2009, Poyry only sampled .3% of Sino-Forest estate. That sample was not broken down by planted versus purchased plantations, so the results are even more attenuated in relation to any assessment of BVI purchased plantation forestry assets held by Sino-Forest. In neither 2008 nor 2009 did the report differentiate between BVI and WFOE assets.

[502] There was also documentary evidence at trial that several people, including people from Poyry, expressed doubts about the utility of the reports at the time. Poyry personnel expressed concerns that their valuation approach was incorrect as it was based on a fundamental misunderstanding of Sino-Forest's business model, i.e., management and harvesting at maturity as opposed to active trading in standing timber plantations. Apparently, Poyry refused to permit Sino-Forest to include its 2009 valuation as supporting document for a Sino-Forest bond issue. One former Poyry employee was recorded in a memo as saying that "It is my concern that the December 2009 Sino-Forest valuation report is unsafe, and may substantially over-value the resource."

[503] Although hearsay, most of this information was admitted into evidence on the basis that the nature and quality of the evidence would go to weight rather than admissibility. Given that the evidence is so controversial, the inability to cross-examine about the preparation of the Poyry reports and the quality of the due diligence performed places a significant limitation on the weight to be placed on them. In addition, it is clear that the Poyry reports were based on forestry data that was provided by Sino-Forest management. The Poyry valuations were based on a small sample to begin with and the sample of BVI purchased forestry assets (the assets that are at the heart of this action) was essentially insignificant. In any event, the Poyry reports simply do not address the question of whether Sino-Forest actually held valid title to its forestry estate, including the BVI standing timber assets.

[504] The Poyry reports constitute some evidence that an independent forestry expert placed significant value on Sino-Forest's forestry assets. In the context of the issues in this trial, however, and given the limitations outlined above, I conclude that the Poyry reports do not provide any reliable evidence that Sino-Forest held valid title to its BVI standing timber plantations or that the BVI standing timber assets Sino-Forest owned were worth $2.99 billion.

The Jingtian & Gongcheng Legal Opinions

[505] Similarly, the defendant also relies on the fact that legal opinions concerning ownership of forestry assets were obtained from the Jingtian & Gongcheng law firm between 2004 and 2010. The defendant argues he was entitled to rely on these opinions as support for his assertion that Sino-Forest subsidiaries held valid title to BVI standing timber assets. Xu Ni attached twelve legal opinions from the Jingtian & Gongcheng firm which address Sino-Forest's title to various standing timber assets (WFOE and BVI).

[506] For similar reasons to those relating to the Poyry reports, only limited weight can be given to these opinions. No witness attended to testify in support of these opinions. The full scope of the due diligence and the assumptions and information upon which these opinions were based is not set out. The opinions are, again not surprisingly, significantly qualified. For example, the opinions typically state that they assume all documents are authentic and that all seals, signatures and "chops" are authentic. A "chop" is a very important personal identification and authorizing stamp in Chinese culture and business.

[507] The March 10, 2007 opinion (Exhibit 8 to the Xu Ni affidavit), states that it is based, among other things, on "the relevant facts confirmed by Your Company" and on certain documents "given your assurance that the documents made available are complete and genuine." The opinion goes on to state that a foreign company that has the "new version" of a "Forest Rights Certificate" issued by the government at the place where the forest is located can prove its lawful rights over the forest. It goes on to note that where the new version of a Forest Rights Certificate is not yet available, the "old version" of a forest rights certificate can still be regarded as valid evidence for proof of forest rights. If even the old Forest Rights Certificate cannot be processed, a letter of confirmation from the local forestry administration "can be regarded as a valid document of proof that the foreign company is in possession of the ownership of the forest they have acquired."

[508] Because the very foundation of the legal conclusions is based on the validity and veracity of information and documents provided by management at Sino-Forest to the law firm, the nature and scope of disclosure, and what, exactly, that disclosure was, is essential to placing any reliance on the legal opinions in the context of the issues presented in this case. In these Reasons, I have found that the documents supporting the BVI standing timber purchases were not *bona fide* and the information provided to Sino-Forest's professional advisors (and to the public) was not honest or complete. For these reasons, I do not find the Jingtian & Gongcheng opinions (or the Poyry

reports) to be of significant probative value on the question of the validity of Sino-Forest's title to the BVI standing timber assets.[5]

[509] As well, as is the case with the Poyry valuation reports, these opinions were available to all potential and actual purchasers of Sino-Forest's assets before, during and after the CCAA sales process. The evidence is that no one, in spite of these opinions, was prepared to ascribe any material value to the BVI standing timber assets.

The Area Verification Exercise

a) Background

[510] It is a recurring theme in the defendant's argument that the bondholders gave up on Sino-Forest too early, concluded that a restructuring was the only way to go and, in doing so, failed to exercise due diligence in the verification and realization of Sino-Forest's BVI standing timber assets.

[511] One particular manifestation of this argument is that the bondholders decided to shut down an area verification exercise being conducted by Indufor, an independent forestry consultant, even though, the defendant alleges, Indufor was meeting with considerable success. The bondholders did this, Mr. Chan argues, because they just wanted to get on with the restructuring.

[512] I cannot accept this argument for two reasons. First, it fails to recognize that the bondholders were highly motivated to maximize their returns. Second, it is not supported by the evidence.

[513] The bondholders held Sino-Forest debt of about $1.8 billion. The evidence in this case is that they realized somewhere in the vicinity of about $438.5 million from the sale of all of Sino-Forest's assets, resulting in a shortfall to the bondholders of well over $1 billion. If the BVI standing timber had value, the economic motivation of the bondholders was to find and unleash that value, not to walk away from it. The defendant has not explained in any satisfactory manner why the bondholders would shut down what the defendant says was a successful, albeit a time-consuming, process if it held out the promise of a much larger recovery.

[514] I have no doubt the bondholders lost faith in senior management and the company, which contributed to their decision to pursue restructuring. But that loss of faith was, in significant measure, the result, not the cause, of the lack of success of the area verification exercise. All of the evidence supports this conclusion.

[5] Section 123 (4) of the *CBCA* provides a defence to a director or officer who relied in good faith on audited financial statements or other professional reports. In my view, Mr. Chan cannot rely on these defences because his "reliance" was not in good faith. There was a failure of honest and complete disclosure. Mr. Chan and Inside Management provided false information to and concealed information from Sino-Forest's auditors and other professional advisors.

[515] One of the functions of the IC was to verify the existence and ownership of Sino-Forest's timber assets, including the BVI standing timber. The IC advisors were able to tie all relevant purchase and sale contracts of standing timber back to Sino-Forest's reported revenue. What was less apparent from the company's records was how to locate Sino-Forest's BVI standing timber.

[516] The proof of concept exercise was developed to determine if specified forest areas, in particular the forest covered by the BVI standing timber purchase contracts, could be located and quantified by independent forestry experts. Sino-Forest retained two experts, Indufor and Stewart Murray.

[517] There is significant disagreement between the parties about the results of this proof of concept exercise. There is disagreement about whether the asset verification process was, or was not, pursued with sufficient diligence and whether it was or was not successful in locating BVI standing timber assets.

[518] The plaintiff says the asset verification process was a dismal failure with respect to BVI standing timber.

[519] Maps were essential to the area verification process. This was because the contracts and supporting documents themselves did not provide enough information to locate the standing timber plantations. The only maps actually produced were provided by former senior management. After 10 months of effort, Indufor was able to locate:

(a) 93% of WFOE planted plantations;

(b) 44% of WFOE standing timber plantations; and

(c) 1% of BVI standing timber plantations.

According to Indufor, the BVI standing timber represented about 64% of the total volume of timber assets and 85% of the book value.

[520] Maps covering the BVI standing timber were not forthcoming. Because 10 months of intensive work resulted in the verification of only 1% of the BVI standing timber assets, Sino-Forest concluded the exercise was futile and instructed Indufor to discontinue further area verification work. The Monitor and the bondholders supported that decision.

[521] The defendant argues that the proof of concept exercise was successful and that Indufor was "steadily" verifying Sino-Forest's timber assets throughout 2012. This area verification process only stopped at the insistent of the bondholders who, by October 2012, were focused on the CCAA process rather than preserving Sino-Forest as a viable, ongoing entity.

[522] In his evidence, Hung testified that, pre-Muddy Waters, the Sino-Forest Resource Department was able to get maps and locate Sino-Forest plantations when needed. Hung testified that he often required access to maps and location information to allow Poyry, auditors, and

insurers to visit standing timber plantations. During Poyry's annual valuations, the Resource Department would provide a map to Poyry, either from maps in its possession or by borrowing maps from the forestry bureau. Poyry, Hung testified, never raised an issue with the maps received and, in fact allegedly remarked on the precision and reliability of those maps. As noted earlier, no one from Poyry testified at the trial.

[523] The final IC report summarized Indufor's work on the proof of concept:

(a) maps of two timber compartments were provided by Sino-Forest to Indufor. These maps were borrowed from the contracted survey company which, in turn, had borrowed them from the forestry bureaus;

(b) the two maps clearly showed the extent of each compartment's boundary that corresponded to those in surveys related to the contracts;

(c) each compartment's boundary was able to be spatially located for use with a geographic information system;

(d) the forestry experts located and physically visited the two forest compartments;

(e) the use of recent high-resolution satellite images allowed the removal of gaps and areas of un-stock forest from the calculation of each compartment's net stocked area; and

(f) the net stocked area calculated by the verification process for the two compartments slightly exceeded that stated in the forestry survey reports attached to the Sino-Forest purchase contracts for the compartments.

Over subsequent months, Indufor was only able to obtain five additional maps.

[524] The defendant says there is a credible explanation for this paucity of maps. Evidence from forestry experts working for the IC as well as Sino-Forest management and witnesses who testified at the trial was to the effect that maps are sensitive in China for security reasons and could be subject to state regulation. There were restrictions on forestry maps being provided to foreigners and on the digitization or copying of these maps.

[525] As part of its investigation, the IC also referred to its understanding from management that maps were not readily available for continuing possession by persons trading in standing timber without a lease, as was the case with the transactions under Sino-Forest's BVI model. Management indicated to the IC that maps can usually be borrowed from forestry bureaus (but not retained) and were used by survey companies as part of Sino-Forest's due diligence.

[526] In addition, the computers that Indufor used were isolated from the Internet for security reasons. Sino-Forest staff was often required for certain data transfer functions and the digitization process could only be conducted in Sino-Forest's Guangzhou office.

[527] Following publication of the Muddy Waters Report, Sino-Forest also became highly vulnerable to staff departures and lacked direction from knowledgeable senior management. Concerning the BVI standing timber, the organization had been decimated with staff departures. In particular, knowledge of the location, village and forestry bureau relationships no longer existed in a number of cases. This had an adverse impact on Sino-Forest's business, financial condition and operations.

[528] All of this evidence, according to the defendant, helps explain why it took so long to produce certain maps and why the verification process went so slowly for BVI standing timber assets.

[529] The defendant argues the initial proof of concept was a success. Indufor expanded the scope of its review between January and July 2012 to cover an increasing amount of Sino-Forest's forest estate. By the time the project was stopped, Indufor had located seven BVI standing timber plantations: the two located during the proof of concept exercise; and five more which were located subsequently.

[530] The defendant argues that the asset verification project did not come to an end because maps were unavailable. Rather, he argues that it was terminated because the process was slow and expensive and the bondholders wanted to reduce ongoing cash outlays and focus on restructuring which was by then a "foregone conclusion."

[531] Mr. Chan points to Indufor's final report to the effect that, as of October 15, 2012, it had obtained access to hundreds of compartment maps for BVI purchase contracts and WFOE plantation rights certificates that cover 158,735 ha representing close to 20% of the 806,685 ha of Sino-Forest's reported timber assets. The defendant argues that it is not true that Sino-Forest was unable to obtain maps for its standing timber assets.

[532] The defendant also relies on certain email correspondence introduced by Mr. Chan in his evidence to support the argument that Sino-Forest staff continued to obtain maps and provide them to Indufor through October 2012.

[533] Although he concedes the asset verification process was time consuming, the defendant says there is no evidence to suggest that the process could not be completed and the total timber assets, including the BVI standing timer of Sino-Forest, verified. The defendant argues that a negative inference should be drawn against the plaintiff for his failure to call Indufor, who were responsible for the area verification exercise.

b) Analysis

[534] It must be remembered that the area verification process was only designed to do one thing – find the standing timber plantations. It offered no comfort or assistance on the even more important questions of whether Sino-Forest owned or could prove that it owned the BVI standing timber assets on its books or what they were actually worth.

[535] I find that the area verification project was terminated because it was a long, labour intensive and costly process which produced little or no reliable information. After 10 months of work, only seven BVI standing timber plantations, 1% of the total BVI standing timber, could be located. The maps which allowed Indufor to locate those seven plots were all provided by Sino-Forest management. As a result, the provenance of these maps is unknown and their validity must be suspect. The *bona fides* of those maps was never proved.

[536] The only real success in the exercise was in relation to forest plantations that are not in dispute – the WFOE planted plantations.

[537] The Court-appointed Monitor, Engen, was clear in his evidence in chief and during his cross-examination that, from his perspective, the area verification process was not making headway due to the lack of maps. Ten months after the Indufor asset verification process had been initiated, the Monitor reported to the Court, in his tenth report of October 18, 2012 (at pp. 11 - 12) that:

(a) Sino-Forest had been able to provide Indufor maps for the majority of the compartments which are on leased lands (i.e. WFOE plantations);

(b) Sino-Forest had been able to produce less than 1% of the maps for compartments which did not include land leases; and

(c) the maps were provided by certain of the former senior management group of Sino-Forest.

[538] The Monitor also concluded that it was not clear “how the Company would be able to identify the relevant areas of timber purchased by the BVI’s at the time of sale or harvesting.” The Monitor advised that, in light of recent results from attempts at obtaining maps, Indufor had been instructed by Sino-Forest to discontinue further area verification work.

[539] During cross examination, Engen said:

> Q. It was requested by the affected creditors to shut it [the area verification process] down?
>
> A. Yes. I think that, consistent with what we've said in our reports and in other places, the fact that they weren't doing anything in September, because they didn't have any maps, was an overriding thing. So I think if they had, if there had been, you know, the 26 maps had been produced and they were making good progress, certainly the Monitor would have been saying, no, we don't think you should wind down this process. But because there was no maps and no progress was being made, we all agreed that it was futile to continue to pay them for not making any progress.

[540] It was also suggested to Engen that new maps were being produced after September 2012:

> Q. And you don't know, Mr. Engen, you're not there, whether or not Indufor received further maps after September 2012, do you? You just don't know, do you?
>
> A. To the best of my knowledge, they did not. It would have been a very big deal for many, many people if Indufor had received a map in September. Because we would have been saying, "Hold on. If maps are now being delivered, let's continue this process".

[541] In June 2012, Indufor was told to focus on BVI standing timber exclusively and was given a deadline of September 2012. The process was continuing in August 2012, when the Monitor reported that "work being performed by third party consultants to verify [Sino-Forest's] forestry estate is on-going and estimated to take years to complete and/or to verify a substantial portion of the estate."

[542] Chronologically, the last document referring to additional maps was received by Xu Ni on September 14, 2012. Xu Ni received an email from another Sino-Forest employee who said maps for BVI contracts "were received yesterday… Do we need to provide to Indufor?" No maps were attached to the email.

[543] There is no evidence Xu Ni responded to this email or took any further action. Specifically, there is no evidence this email, or any further maps, were forwarded to or brought to the attention of Mr. Judd Martin (who had taken over from Mr. Chan as CEO) or Indufor.

[544] Although Xu Ni did not tell Mr. Martin that additional maps had been obtained, she testified it was "possible" that this information was sent directly to Martin by someone else. Although Martin was scheduled to testify as part of the defendant's case, the day following Xu Ni's cross examination counsel for Mr. Chan advised that Martin would not be testifying. As a result, there is no evidence Martin was ever advised of the September 14, 2012 email to Xu Ni. Nor is there any evidence that additional maps were ever produced or provided to Martin or Indufor.

[545] To the contrary, a comparison of Indufor's September 30 and October 30, 2012 reports suggests that no new maps came to light in October 2012. Indufor's September report refers to maps permitting confirmation of 5,542 ha of BVI standing timber. Indufor's final report of October 30, 2012 also refers to the same final number, confirmed BVI standing timber of 5,542 ha. In its final report, Indufor did report that as of October 15, 2012, three of the randomly selected 26 BVI sale and purchase agreements had been mapped and that maps had been requested for other compartments. However, nothing that happened in October 2012 resulted in any increase in the volume of BVI standing timber that Indufor was able to locate. The only reasonable inference is that no new maps helpful in locating BVI standing timber were provided.

[546] I am also unable to accept the argument that Chinese government security concerns prevented Sino-Forest from obtaining maps. I say this because Sino-Forest was able to procure

maps for almost all (93%) of its WFOE planted plantations and a significant portion of its WFOE standing timber. While it is true that a BVI company is not a Chinese company and that a WFOE is, both are by definition wholly foreign owned. I cannot accept that a security policy of the People's Republic of China would be so credulous and porous that it would fail to account for this obvious problem.

[547] Mr. Hao, the defendant's forestry expert, could not accept this either. He agreed that a policy for security purposes that restricted a foreign company's access to maps but placed no restriction on a PRC company that was wholly foreign owned made no sense. "For those like government authorities," he said, they are "still a foreign company." The evidence of Song Li and Qin Tianbao, the plaintiff's Chinese forestry and law experts, was to similar effect.

[548] When Indufor was engaged to attempt to find BVI standing timber plantations, Indufor explained that it required maps. Unlike the WFOE planted plantations for which Sino-Forest had maps, management was ultimately only able to produce maps for 1% of Sino-Forest's claimed BVI standing timber holdings. The process was terminated because, according to independent management and the Monitor, it was costly and producing no positive outcomes.

[549] Chandler Fraser Keating, the bondholders' and then Emerald Plantations' forestry experts, were equally unsuccessful, reporting that any efforts to find the BVI plantations beyond what Indufor had done would be "impractical as there was virtually no one who knew the exact location of the forest." This report is consistent with the expert evidence this Court heard from both Mr. Chan's and the plaintiff's forestry experts, which is set out above.

[550] The lack of maps cannot be blamed on the departure of Sino-Forest staff. It was in Mr. Chan's interests, and the interests of Inside Management, that maps be found. They, perhaps more than anyone, were incentivized to prove Sino-Forest owned the BVI standing timber. Yet, nothing was or has been forthcoming from Mr. Chan or Inside Management. Despite the fact that EPHL received all of Sino-Forest's assets (including its operations and subsidiaries), not one Sino-Forest employee was able to point EPHL to the BVI assets. Based on the absence of evidence that the BVI assets existed, Brough, and later Dubow, concluded that the assets were not real and ascribed them a "nil" value in EPHL's financial statements.

[551] The former assets of Sino-Forest have now been in the hands of New Plantations for more than a year. Even with Mr. Chan's assistance, New Plantations has not produced any evidence that it has been able to find, prove title to or monetize any purported interest in the BVI standing timber assets. It has not paid anything to EPHL under the RAPA arising out of the sale of any BVI assets. The best Mr. Chan can offer in this regard is revealed in the evidence of Alvin Lim, who testified that New Plantations is "still in the process of investigation."

[552] Six years have passed since the Muddy Waters Report was released and nobody , despite enormous financial incentives to do so, (incentives motivating Sino-Forest, the bondholders, the purchaser Emerald, the purchaser New Plantations and Mr. Chan himself), has been able to locate, confirm ownership of, or monetize the BVI assets. When considered in the context of all the

evidence, the inescapable conclusion is that Sino-Forest did not own the BVI assets that it claimed to own.

[553] All of the evidence considered as a whole, leads to the inescapable conclusion that the BVI standing timber model was a fraud. The logical and reasonable inferences to be drawn from the totality of the evidence, based on a preponderance of probabilities, are that:

i) the defendant and others inside and outside Sino-Forest management operated an elaborate system of nominee companies ultimately controlled by Mr. Chan or persons acting under his direction;

ii) many of these nominees companies were major Suppliers of BVI standing timber;

iii) the Suppliers and AIs were not b*ona fide* arm's length sellers and purchasers of BVI standing timber;

iv) the BVI standing timber transactions were paper transactions. Sino-Forest employees under the direction of Mr. Chan and his cadre of Inside Management created the contracts, the supporting documents and the so-called evidence of directed payments made between the AIs and Suppliers. No consideration in fact passed between these entities;

v) Sino-Forest subsidiaries did not hold title to BVI standing timber plantations;

vi) the value of Sino-Forest's BVI standing timber, represented at $2.99 billion in 2011, did not exist. Because Sino-Forest did not own these assets, this value was nil; and

vii) the defendant and members of Inside Management exploited weaknesses and ambiguities in the PRC forestry regulatory regime to perpetrate this fraud and to conceal it from scrutiny by Sino-Forest, external auditors, other professional advisors, independent members of the Board and the public.

The WFOE Standing Timber Fraud

[554] The WFOE model involved both purchased plantations and planted plantations. The plaintiff has made no claims concerning the WFOE planted plantation model in this proceeding.

[555] However, the plaintiff does allege that a significant proportion of the purchased plantation side of the WFOE business was a fraud that was implemented through fictitious transactions with counterparties that were secretly controlled by Mr. Chan and Inside Management.

[556] According to Sino-Forest's records, Kun'an was Sino-Forest's largest supplier of WFOE purchased plantations from August 2007 until July 2011. Yuda Wood was also a large supplier. Both these Suppliers were controlled by Mr. Chan and Inside Management.

[557] Nine of Sino-Forest's WFOE purchased plantation Suppliers are listed on the Nominee Company Manager List. Many of those companies were "peripheral companies" for which Zeng obtained signed nominee documents. There are also other connections alleged between Mr. Chan, Inside Management, and the WFOE purchased plantation counterparties, all of which are detailed in Annexure 6 to the Borrelli Affidavit.

[558] Sino-Forest lacked plantation rights certificates for the majority of its WFOE purchased plantations. The IC and the Litigation Trust collectively were only able to locate plantation rights certificates accounting for 17.5% of Sino-Forest's WFOE purchased plantations, almost all of which were actually issued in the names of Sino-Forest's Suppliers rather than the Sino-Forest subsidiary that supposedly owned the plantations. Sino-Forest did not have plantations rights certificates for over 82% of its claimed WFOE purchased plantations.

[559] Sino-Forest also did not have maps for the majority of its WFOE purchased plantations. When Indufor was retained to attempt to locate Sino-Forest's claimed timber holdings, Sino-Forest was unable to produce maps for 86.6% of its purchased plantations under the WFOE model. In particular, Sino-Forest produced maps for 13,780 of the 31,371 hectares (or 44%) of its purchased plantations where Sino-Forest leased the underlying land but was unable to produce a single map for any of the 71,577 hectares where Sino-Forest did not lease the underlying land. By contrast, Sino-Forest was able to produce maps for 93% of its WFOE planted plantations.

[560] The essential hallmarks that make the BVI standing timber model a fraud are present in the WFOE purchased plantation model as well. The counter parties were not arm's length. In spite of the fact that by 2011, 86% of China's forested area was covered by new form plantation rights certificates, only 17.5% of the WFOE purchased plantations had certificates.

[561] No explanation was offered by the defence for this anomaly. There is no evidence of any material realization of value from these purported assets.

[562] In the circumstances, I can only conclude that, like the BVI standing timber, the majority of the WFOE purchased plantations were never actually owned by Sino-Forest and had no value.

The Wood Log Trading Cash Gap Fraud

Overview

[563] Part of Sino-Forest's business model included wood log trading. The purchase, importation and sale of logs was a significant contributor to the overall revenue of Sino-Forest. From 2005 to 2010, revenue from wood log trading ranged from 15% to 25% of Sino-Forest's total revenues. Wood log trading did not, however, have a comparable contribution to Sino-Forest profits. Profit from wood log trading over the same period ranged from 1 to 3% of Sino-Forest's total profits.

[564] The plaintiff claims that from 2006 to 2011, under the wood log trading model, Sino-Forest made cash payments to its wood log suppliers for the purchase of wood logs. Purchases were generally funded by, and settled through, trust receipt credit facilities guaranteed by Sino-Forest. Thus, a bank would pay the wood log supplier for the purchase of the logs and Sino-Forest and its subsidiaries would incur a liability, secured by a letter of credit, to repay the bank.

[565] Sino-Forest would then immediately sell those logs to a purchaser, receiving payment mostly through remittance agents. However, on average, only about 70% of wood log sales accounts receivable were paid in cash by Sino-Forest's customers. The remaining 30%, on average, was "paid" by directing set-off payments from Sino-Forest's wood log trading customers to its BVI standing timber Suppliers. These directed payments were used to satisfy Sino-Forest's accounts payable to BVI standing timber Suppliers. This had the effect of diverting "new" money into the BVI standing timber model and increasing the stock of BVI standing timber assets held in Sino-Forest's portfolio.

[566] The plaintiff takes the position that, since the BVI model was a fraud, the recorded set-off payments from wood log trading customers never actually occurred (or, if they did, resulted in no value to Sino-Forest). The result was a "skimming fraud" in which Sino-Forest paid out $239.8 million more in cash to its wood log suppliers than it received from its wood log customers. The difference is the "cash gap."

[567] Further, after the Muddy Waters Report, essentially no outstanding obligations owed to Sino-Forest for wood log trading were paid. The non-payment of the wood log trading receivables after June 2, 2011 led to a "further cash gap" of $93.4 million, for a total loss of $333.2 million.

[568] The defendant argues that this claim is barred by the doctrine of affirmation and the *Limitations Act*. Further the defendant argues that the direction of payment for log sales into BVI standing timber assets was *bona fide*; it enabled Sino-Forest to meet its obligations to BVI standing timber Suppliers and resulted in the acquisition of valuable BVI standing timber assets.

[569] I have concluded that the preliminary issues raised by the defendant, affirmation and the limitation period, do not bar this claim. I have further concluded that the diversion of funds into BVI standing timber was a fraud. The diversion of these funds did not result in the acquisition of any asset or produce any value for Sino-Forest.

[570] My reasons for reaching this conclusion are set out in detail below.

Were the Contracts Affirmed?

[571] The defendant raises two preliminary issues regarding the cash gap fraud claim, as well as a substantive defence.

[572] First, the defendant argues that the basis of the cash gap fraud is that Sino-Forest loaned money to its subsidiaries to finance the wood log trading model and was never repaid. Once these

loan agreements were affirmed when Sino-Forest conveyed them under the CCAA Plan, the plaintiff was precluded from making a claim for damages on the basis that these loans were advanced as a result of fraudulent misrepresentations.

[573] I have dealt with this argument earlier in these Reasons. In my view, the doctrine of affirmation has no application in the circumstances of this case. I therefore reject the defendant's first preliminary argument.

The Limitations Defence

[574] The defendant's second preliminary argument is that the facts underlying this particular allegation of fraud were known to independent management as early as 2008 and, in any event, by the end of 2011 and, therefore, upon the plaintiff's appointment in 2013. The defendant therefore argues that the claim based on the wood log trading cash gap fraud was known or discoverable more than two years before the claim was advanced by way of motion to amend the statement of claim in August 2016. The defendant argues, therefore, that the claim is barred by the *Limitations Act*.

[575] Section 4 of the *Limitations Act, 2002,* S.O. 2002 c.24 provides that a proceeding shall not be commenced in respect of a claim after the second anniversary of the day on which the claim was discovered. Section 5(b) defines "discovery" as "the day on which a reasonable person with the abilities and in the circumstances of the person with the claim first ought to have known" of the injury, loss or damage alleged to have been caused by the defendant's act or omission.

[576] The defendant argues that the cash gap fraud is a new claim. The plaintiff is required to plead fraud with a high level of particularity. The plaintiff's statement of claim before the motion to amend contained specific allegations identifying 16 distinct "frauds" advanced by the plaintiff. These did not include the cash gap fraud allegations. The motion to amend, by adding the cash gap fraud, resulted in the pleading of a seventeenth allegation of fraud. It is, therefore, a new "claim" which must meet the test of discoverability in order to stand.

[577] There are essentially two grounds for the defendant's argument on discoverability. First, the defendant points to a governance document prepared under the supervision of Thomas Maradin in 2008. The December 2008 TRE NI 52-109 Material Weakness Disclosure Form for "Netting Accounts Receivable with Accounts Payable on Timber Operations" describes that log trading customers of Sino-Forest sometimes satisfied accounts receivable for wood log purchases by paying the money to Sino-Forest's standing timber Suppliers. The internal control report goes on to identify the potential for fictitious or unauthorized setoffs on accounts receivable and payable being made.

[578] In cross examination, the plaintiff conceded that the fictitious or unauthorized setoff of accounts receivable and payable described in the internal control document prepared by Maradin for the years 2009 through 2011 is what the plaintiff alleges occurred in the wood log skimming fraud.

[579] In addition, Maradin, the author of the TRE NI 52-109 internal control report, worked for the plaintiff as a consultant following the plaintiff's appointment from August 2013 through to February 2016. Maradin's responsibilities were to provide guidance and direction in the investigation of Sino-Forest's historical transactions and the use and destination of the funds raised by Sino-Forest.

[580] During Maradin's cross examination, he explained that he personally investigated the transaction process set out in the TRE NI 52-109 for netting out accounts receivable from wood log trading customers by directing the customer to pay Suppliers in the BVI standing timber model. He also confirmed that there were corporate documents confirming the transactions and receipt of funds by the BVI Suppliers.

[581] Second, during the IC Investigation, counsel to the IC, Jean Fraser of Osler Hoskin & Harcourt LLP, identified the circumstances of the very transaction the plaintiff relies on as the archetypal example of the wood log trading cash gap fraud transactions. In her email, Ms. Fraser expressed her concern that more money was going into the BVI structure from Sino-Forest's offshore funds by wood log trading customers settling accounts receivable by paying accounts payable to BVI Suppliers. Fraser wrote:

> If this is the case, BVI funds outside of China or accounts receivable offshore in foreign exchange are being transferred by way of set off into China. There is a concern that such set-off arrangements may be problematic for a Chinese foreign exchange control perspective and may also add to the problematic BVI assets/trapped funds within China.

[582] Fraser's email uses a sample transaction to illustrate how funds due from a wood log trading customer were being set off against Sino-Forest's accounts payable to a Supplier in the BVI standing timber model. The sample transaction is the transaction relied on by the plaintiff, whereby Suifenhe Longtai (a wood log customer) partially paid its account receivable owed to Sino-Forest by paying the accounts payable of Sino-Forest's BVI subsidiary, Rich Choice, to a standing timber Supplier, Zhanjiang Bohu.

[583] The plaintiff conceded in cross-examination that even if he did not review the email himself, the email was available to his counsel, Mr. Staley, who was an addressee on the email. In any event, Fraser's email is appended to the Second IC Report. There is no doubt the plaintiff had access to the second IC Report and its conclusions. Indeed, the IC investigation is specifically referenced in the Amended Statement of Claim at paras. 53-60.

[584] Thus, the defendant argues, since at least 2011 Sino-Forest, through its counsel (and, since his appointment in 2013, the plaintiff), has had the documents and underlying facts the plaintiff now relies on to support the wood log trading cash gap fraud claim that was not made until August 2016.

Analysis of *Limitations Act* Issue

[585] There are two issues to be addressed:

(1) is the cash gap fraud a new cause of action or, to use the language of the *Limitations Act*, a new "claim" asserted by way of a "proceeding" for the first time in August 2016; and, if it was,

(2) was that claim "discoverable" before August 2014, that is, at least two years prior to the motion for leave to advance that claim.

[586] A cause of action means a factual situation, the existence of which entitles a person to obtain from the court a remedy against someone else. It is well settled that a new legal conclusion drawn from facts already pleaded will not constitute a new cause of action. It is also the case that proposed amendments which serve to particularize a cause of action that has already been pleaded also do not constitute a new cause of action: *Ivany v. Financiere Telco Inc.* 2011 ONSC 2785, 207 A.C.W.S. (3d) 664, at para. 30. Adding clarity, precision and definition to an existing claim should not be discouraged, as these are attributes of a good pleading: *Toronto Standard Condominium Corp. No. 2051 v. Georgian Clairlea Inc.* 2016 ONSC 2948, 266 A.C.W.S. (3d) 60, at para. 62.

[587] In this case, the claim is some 72 pages long, consisting of 236 paragraphs. Paragraph 1 contains the prayer for relief which includes a claim for damages of $3 billion for losses suffered as a result of fraud, breach of fiduciary duty and negligence. Paragraph 9 pleads that Mr. Chan caused Sino-Forest to materially overstate the value of Sino-Forest's revenue and assets and concealed personal profits made by Mr. Chan as a result. Paragraph 9 goes on to plead particulars which include the allegation that Mr. Chan had operational and *de facto* control over allegedly arm's-length purchasers of Sino-Forest's timber and the Suppliers of that timber, that Mr. Chan caused Sino-Forest to significantly overpay for assets sold by companies which Mr. Chan secretly controlled and that Mr. Chan caused monies to be paid out by Sino-Forest and its subsidiaries for no proper purpose.

[588] At paragraph 85, the claim pleads that by controlling the Suppliers, AIs and other nominee companies, Mr. Chan and Inside Management carried out transactions which either overstated the economic substance of the transactions or which were entirely fictitious. Paragraph 88 pleads that Mr. Chan personally profited from these insider relationships with related parties, the full particulars of which were known only to Mr. Chan. Further particulars, the pleading goes on to say, of the secret profits made by Mr. Chan in connection with related party entities will be provided prior to trial.

[589] Paragraphs 108 to 110 plead that Mr. Chan and Inside Management caused Sino-Forest to enter into a number of transactions that were fraudulent or devoid of any legitimate business purpose. They allege that Mr. Chan and Inside Management perpetrated this massive fraud by papering hundreds of fictitious transactions, "the full particulars of which are known only to

Chan." The claim goes on to state that further particulars will be provided prior to trial but that the following transactions are "illustrative" of the fraudulent conduct perpetrated by Mr. Chan and Inside Management. What follows is a list of 16 transactions or types of transactions, which the plaintiff says fall into the categories of fraud or breach of duty pleaded earlier. These particulars include the illegitimacy of the transactions with AIs and Suppliers in both the BVI and WFOE models, improper prepaid deposits in the wood log trading business, improper prepaid deposits in other businesses and a number of other specific allegations involving particular transactions or types of transactions. The cash gap fraud allegations in the amended claim are added as the seventeenth particular of the general allegation of fraud set out above.

[590] The defendant's premise for its limitations argument, that allegations of fraud must be pleaded with "full particulars," while undoubtedly true, confuses the rules of pleading with particularity (Rule 25.06(8)) with the initiation of a proceeding for a remedy under the *Limitations Act*.

[591] The statement of claim, before the August 2016 amendment, constituted a proceeding which pleaded, generally, causes of action in fraud and various breaches of duty. The pre-amended claim also pleaded facts which, again generally, encompass the type of conduct ultimately relied on as the specific foundation of the cash gap fraud. That claim was sufficient to fulfil the *Limitations Act* requirement. The plaintiff was unquestionably required to provide particulars of the cash gap fraud in order to pursue that issue at trial. That obligation, however, arose as a matter of trial fairness – the defendant was entitled to know the case he had to meet – not as matter of whether a proceeding had been commenced to assert a claim within the two year limitation period.

[592] For this reason, I reject the defendant's argument that the cash gap fraud allegations are barred by the *Limitations Act*.

[593] In the event that I am wrong in this conclusion, I will also deal with the defendant's argument on discoverability.

[594] Discoverability, as I said on the motion for leave to amend in August 2016, would involve the question of when a reasonable litigation trustee, with the abilities and in the circumstances of the plaintiff, first ought to have known about the facts on which he now seeks to rely in order to assert the wood log cash gap fraud allegation.

[595] Mr. Borrelli gave a good deal of evidence about the magnitude of the task he took on in January 2013. The Sino-Forest structure was labyrinthine. There were many business lines, hundreds of corporations and thousands of transactions all involving a business that had been operated over many years. No one previously had actually tried to trace the flow of funds. Mr. Borrelli decided to do that because he felt it would lead him to the people he would need to sue as Litigation Trustee. His evidence was that analysis took 2 ½ years.

[596] Following Mr. Chan's discovery, Mr. Borrelli decided to focus more on the timber suppliers, China Square and Flying Profit. That led to the preparation of set off schedules which showed a pattern, not just isolated instances, of receivables from wood log trading being set off against purchases of BVI standing timber. The key to this particular allegation, however, was not that there were set offs or that there were questionable relationships among Sino-Forest and its suppliers and customers but that, only after carefully analyzing all of the transactions did he realize that, on average, 30% of the payments to Sino-Forest for the sale of logs was made by way of set off against purchases of additional BVI standing timber. It was that analysis that led to the realization that $239.8 million more was paid out to log suppliers than Sino-Forest received back from log purchasers when the logs were sold. That realization, Mr. Borrelli testified, came about for the first time in May 2016. The motion to amend was brought in August 2016, well within the two-year period from when the particular fraud was discovered.

[597] I am not persuaded the Maradin internal control document was sufficient to put independent management, the IC, the Monitor or the Litigation Trustee on notice that the log trading model involved a material fraud. The cash gap fraud is different from the on-shoring problem, different from the related-party problem and different from, although related to, the problem of whether Sino-Forest actually owned any BVI standing timber assets. There is nothing about the TRE NI 52-109 Material Weakness Disclosure Form to indicate the wood log receivables were in US dollars or that the BVI standing timber assets were fictitious. I also conclude that the identification of a process weakness, that is, a risk that something *might* go wrong, is very different from a discovery that something *has* gone wrong or that would put a reasonable person on inquiry about whether something has gone wrong.

[598] Similarly, the concerns raised by the IC's counsel were about the on-shoring problem - that is, increasing the stock of BVI standing timber - and the potential of related-party dealing. Nothing about these concerns points to a pervasive, across-the-board average cash gap between what was paid out in what was received of 30%. That realization only came about as a result of painstaking forensic examination of all the transactions, which did not occur until 2016.

[599] These two documents do not constitute evidence that Mr. Borrelli failed to use reasonable diligence in chasing down the cash gap problem in all of the circumstances.

[600] I should also comment on the fact that it was in the nature of these transactions that their true purpose and effect was concealed by Mr. Chan and his senior management. The evidence is that Inside Management, including Mr. Chan, was not helpful or forthcoming in the aftermath of the Muddy Waters Report. The evidence is that relationships between Suppliers and AIs and Sino-Forest and between Sino-Forest personnel and Sino-Forest's suppliers and customers were not disclosed. Mr. Chan maintains still in this litigation that the BVI standing timber model was entirely appropriate and that nothing was wrong. Mr. Chan is critical of the IC, the Monitor, the bondholders, EPHL and the Litigation Trustee for jumping to conclusions and not taking sufficient time to prove that Sino-Forest held title to $2.99 billion of BVI standing timber assets. It is incongruous, in the circumstances, for Mr. Chan, with the benefit of hindsight now that the

problem has been exposed, to claim that Mr. Borrelli slept on his rights and failed to act reasonably to uncover the concealed fraud involving the wood log trading cash gap.

[601] *Golden Oaks Enterprises Inc. (Trustee of) v. Lalonde*, 2016 ONSC 5313, 133 O.R. (3d) 513, set aside 2017 ONCA 515, 137 O.R. (3d) 762, concerns the unique circumstances and challenges faced by a trustee investigating a fraud on behalf of defrauded creditors.[6] The Court noted that discoverability in relation to a Trustee in Bankruptcy is different than in relation to an ordinary person and/or corporation, particularly as it relates to a fraudulent scheme. The Court in *Lalonde* held that claims only become discoverable during the course of the trustee's investigation:

> In a case like this where a bankrupt has perpetrated fraud on creditors of a bankrupt estate prior to bankruptcy, the Trustee acting on behalf of the unsecured creditors must seek to recover those assets which were fraudulently used or transferred by the bankrupt. In doing so, the Trustee will have to conduct various investigations to see if there were fraudulent activities and how the assets were used and who received the benefit from their use. Once this is determined, the Trustee can then decide who has received the benefit of the fraud and by how much they benefitted. Then, the Trustee must determine the appropriate course of action to deal with those situations. It is only during the course of the investigation that the claims will become discoverable.

[602] This conclusion in part reflects the principle that the presence of fraud vitiates the corporate identification doctrine. A corporation cannot be "aware" of a fraud that was perpetrated by its directing minds prior to the discovery of the wrongdoing by the trustee. It would be illogical if the actions of the directing minds who perpetrated the fraud were to be subsumed in the very company they were trying to defraud.

[603] I conclude that there is no evidentiary basis to contradict the Litigation Trustee's assertion that he has been diligently investigating the complex, concealed fraud now alleged against Mr. Chan. The Statement of Claim was amended within two years of the Litigation Trustee's discovery of the cash gap and, accordingly, the cash gap allegations are not barred by the *Limitations Act*.

The Cash Gap Fraud Allegation

[604] Finally, the defendant argues that the plaintiff has not established that Sino-Forest suffered a loss in any event. The underlying asset purchased through the set off or netting process was BVI standing timber. Mr. Chan says the plaintiff has not established that the BVI standing timber does not exist and that the evidence demonstrates that the assets do exist. Nor has the plaintiff

[6] Although this decision was set aside on other grounds, the description of the position of a Trustee was not contradicted and remains, in my view, accurate.

established that the assets purchased in each of the set off or netting transactions were not equal to the value of the accounts receivable that Sino-Forest would have otherwise collected from the wood log trading customer.

[605] As Mr. Chan tried to explain during his cross-examination:

(i) "if you have BVI assets with account payable pending, you have to pay it. One way or another you have to pay it;

(ii) "the BVI trees have values," and

(iii) "so that is, firstly, we have payables obligations we have to pay. Two there are good values."

[606] In other words, according to Mr. Chan, he deliberately chose to direct new cash, not locked into the BVI standing timber model, into the purchase of BVI standing timber assets, thereby subjecting an even larger portion of Sino-Forest's assets to the on-shoring problem.

[607] The defendant nevertheless concedes, at a conceptual level, that, if the BVI standing timber model was a fraud, diverting an additional $239.8 million into non-existent BVI standing timber assets must also be a fraud. My disposition of the BVI standing timber fraud claim is, for this reason alone, dispositive of this issue.

[608] There are, however, three unique features of the cash gap fraud which warrant special attention:

(1) the diversion of USD cash receivables owed by wood log customers toward the acquisition of BVI standing timber assets is completely inconsistent with Mr. Chan's argument about the problems of "on-shoring" and his admission that the WFOE model, available since 2004, was the better business model from Sino-Forest's point of view;

(2) almost none of the purchasers who owed money to Sino-Forest as of June 2, 2011 (for a total of over $93.4 million) ever paid. They all disappeared almost instantly, by becoming deregistered as corporations or otherwise shutting down operations and simply "going dark"; and

(3) the evidence of wood log suppliers and customers not being arm's-length and that senior management of Sino-Forest itself was not arm's-length from some of its major counterparties in this business.

[609] I will address each of these issues in turn.

Diversion of USD Cash into BVI Standing Timber Assets

[610] As set out earlier, the BVI model was "cashless" in the sense that no cash was transferred through Sino-Forest's bank accounts under the BVI model. Unlike the BVI model, the wood log trading model was a cash-based model under which Sino-Forest actually paid and received cash for the wood log transactions.

[611] By directing wood log customers to make set off payments to BVI standing timber suppliers 30% of the time, cash that Sino-Forest otherwise would have received in USD outside of the PRC was supposedly converted into BVI standing timber assets. As the wood log trading transactions resulting in the cash gap took place between 2006 and 2011 – years after Sino-Forest was permitted to operate the WFOE model – cash was purportedly being diverted into the BVI model at a time when Sino-Forest was trying to convert its BVI assets into WFOE assets so that the assets could be monetized outside the PRC. It makes no sense that new US cash was effectively being directed into the BVI model (where the value would be trapped) at a time when Mr. Chan claims Sino-Forest was attempting to turn the BVI assets into cash through what was, to that point, a complicated and unsuccessful on-shoring process.

[612] Mr. Chan's explanation for this was that, in some cases, the purchasers of wood logs did not have sufficient USD to pay USD cash in accordance with their obligations under the wood log trading purchase contract. In those instances, Sino-Forest agreed to let the customer pay in RMB and directed them to pay the requisite amounts to a BVI standing timber Supplier to which Sino-Forest owed accounts payable for BVI standing timber acquisitions. Sometimes, Mr. Chan said, this was the only way Sino-Forest could meet its obligations to BVI standing timber Suppliers.

[613] There are a number of problems with this explanation.

[614] Mr. Chan accepts the reality of the on-shoring problem for BVI standing timber assets. Under Chinese law there were restrictions on foreign currency and foreign corporations doing business in China. This meant that profits on the trading of BVI standing timber had to be "re-invested" in more BVI standing timber assets. The exponential growth of the BVI standing timber assets from 2004 to 2011 created a significant problem. The value in those assets was "trapped" in the PRC and could not be monetized without incurring significant tax, foreign-exchange, regulatory and other risks. Mr. Chan argues this very point in defence of his position on the BVI standing timber.

[615] He says the Board, the IC and the Monitor were aware the BVI standing timber model was a legacy problem. Ernst & Young, Sino-Forest's auditors, were also well aware of the problem. The BVI standing timber profits were locked in the PRC. Because of this, Sino-Forest wanted to move the BVI standing timber assets to the WFOE model, thereby unlocking the value of these assets. No solution for how to do this had yet been found but senior management and professional advisors were working on it. It was clearly understood, however, that this issue arose precisely because the BVI standing timber model was a cashless model. The profits were trapped, so to deploy them profitably, they were ploughed back into more purchases of BVI standing timber.

There was never any suggestion, however, that new cash available to Sino-Forest for use in non-BVI standing timber enterprises would ever be folded into the BVI standing timber model.

[616] The diversion of log trading receivables into BVI standing timber purchases is completely inconsistent with Mr. Chan's attempted justification of the onshoring initiative. Mr. Chan's sworn testimony is that Sino-Forest was trying to migrate from the BVI model to the WFOE model which "was a better model than the BVI model." At a time when he was publicly espousing the need for a solution to the BVI standing timber problem, Mr. Chan now acknowledges that he was authorizing the payment hundreds of million dollars of new money owed to Sino-Forest for log sales to be used for the purchase of more BVI standing timber assets. This is the exact opposite of his position to the Board at the time. The evidence is that the Board was completely unaware of this.

[617] Ardell, who became lead director of Sino-Forest in January 2010, understood management was working on trying to "repatriate" the profits in the BVI model. It was, he understood, desirable to accumulate assets in the WFOE model in preference to the BVI model. Ardell was totally unaware and, to his knowledge, the Board was unaware, that management was using cash raised in the North American debt and equity markets to purchase new BVI standing timber assets. He testified that he was surprised to discover, just prior to testifying at trial, that this was happening.

[618] A second problem with Mr. Chan's explanation is that he never seems to have entertained the possibility that Sino-Forest could simply insist upon the customer's strict compliance with its contractual obligations to pay for the logs in USD. Mr. Chan took the position that there was an urgent need to meet BVI standing timber payables. To meet this need, he chose to direct customers with USD cash obligations for wood log purchases to pay BVI standing timber payables in RMB.

[619] This runs afoul of the evidence that Sino-Forest's BVI standing timber customers, the AIs, always paid, 100% of the time, on average 140 days early. Mr. Chan could not explain why any rational person, given the on-shoring problem, would ever buy more BVI standing timber assets than were supported by payments from AI's on sales of BVI standing timber assets. I agree with counsel for the plaintiff that, in the circumstances, no one would never put themselves in a situation where they were buying more BVI standing timber assets and incurring more liabilities in the trapped model than they knew was coming due as receivables from BVI standing timber sales. If Mr. Chan was legitimately concerned about on-shoring and finding a solution to the locked-in problem, the last thing he would do is incur new liabilities to BVI standing timber Suppliers that required Sino-Forest to pay with new, un-trapped cash.

[620] A third and related problem with Mr. Chan's explanation is why, even if Sino-Forest's wood log customers did not have sufficient funds in USD on hand to fulfil their contractual obligations, he insisted on diverting payment into the BVI standing timber model instead of, for example, the purchase of WFOE model assets. In other words, if an indulgence was being granted to the customer, why not divert the customer's RMB payments to setting off a debt owed to a

WFOE standing timber supplier, so as to at least minimize the growth of the on-shoring problem associated with the BVI standing timber assets being locked up in the PRC.

[621] Mr. Chan's response was, as noted above, that there was an urgent need to pay BVI standing timber suppliers and that the BVI standing timber assets were good value. As discussed above, neither of these propositions has been established on the evidence. I simply cannot accept Mr. Chan's explanations as reliable or credible.

[622] Finally, there is Mr. Chan's evidence that Sino-Forest only directed wood log payables into the BVI standing timber model when wood log customers had no USD, only RMB. The evidence is that most of the PRC customers purchasing wood logs from Sino-Forest used remittance agents or currency converters. The whole point of using remittance agents was to avoid problems with currency controls. It was never explained why the remittance agents, in their capacity as currency converters, could not have facilitated payment in USD, whether or not the customer itself had USD immediately available.

The Disappearance of Wood Log Customers Owing $93.4 Million after June 2, 2011

[623] The last cash payment received from a wood log customer was July 28, 2011, about two months after the Muddy Waters report. Sino-Forest's wood log trading customers walked away from outstanding net accounts receivable owing to Sino-Forest of $93.4 million. The Monitor's Tenth Report (and the testimony of Engen at trial) says that six of the eleven customers who owed money to Sino-Forest were, on investigation, deregistered as companies and no longer existed. Two of them, in fact, had been deregistered for a long time, yet continued to trade with Sino-Forest even after they were no longer registered. The Monitor was unable to make any meaningful contact with any of the debtor customers. They all appeared to have simply vanished.

[624] This is not unlike Sino-Forest's experience with the AIs under the BVI standing timber model. Several of the wood log trading customers had been doing transactions with Sino-Forest entities in the hundreds of millions of dollars. That they would vanish so quickly at the first sign of trouble is highly suggestive of the inference that, in spite of having allegedly engaged in tens of millions of dollars of wood log trading, they were not legitimate operations or companies of any substance.

Unusual Relationships with Wood Log Trading Counterparties

[625] Marco Lam was a friend of Mr. Chan's who worked Sino-Forest from 2001 to 2007. Within a short period of leaving Sino-Forest, Lam's company, China Square, was conducting transactions worth hundreds of millions of USD with Sino-Forest subsidiaries. China Square was the single largest supplier of wood logs to Sino-Forest forest.

[626] China Square is listed on the Nominee Company Managers List with Marco (Lam) as the manager. Lam/China Square had a number of unusual financial dealings with Mr. Chan and Sino-Forest senior management.

[627] In May 2009, Ip authorized a bonus to James Lau, a Sino-Forest employee. Ip sent an email to Lam, telling him to deposit RMB 110,000 to Lau's account. Lam replied: "Will do." Lau confirmed that the payment was made.

[628] In March 2010, Ho advised Mr. Chan and Yosanda that "we" needed $5 million for Jack Chen's Hong Kong company, Great Eastern Developments. A few days later, Lam deposited Hong Kong $5 million in Chen's bank account.

[629] Lam and his companion, Peggy Lo, were also involved in the purchase of Mr. Chan's personal residences in Hong Kong in early 2010. Lam paid for the residences at Mr. Chan's direction. The registered owner of the properties is a company called Shiny Tech Hong Kong Limited. From September 21, 2007 until 2011, Peggy Lo held the shares of Shiny Tech in trust for Mr. Chan's daughters, Joyce and Grace Chan. Mr. Chan agreed in cross-examination that he only trusted Peggy Lo to hold the shares of Shiny Tech due to his trust and faith in Lam.

[630] In May, 2010, at Yosanda's request, Lam forwarded to Mr. Chan an accounting of certain receipts and payments in and out of his companies, Day Best and Shiny Tech. The accounting reflects a HK$2.4 million payment for Mr. Chan's residences and a HK$5 million payment to Jack Chen.

[631] In May 2011, Ernst & Young was threatening to write off a four year old deposit refund owing from Elderbridge, a wood log supplier. David Horsley sent an email to Mr. Chan about this, indicating that a million dollar payment had to be made immediately. Mr. Chan forwarded the email to Hung. Hung then sent an email to Lam at China Square, telling Lam to send Sino-Forest $1 million. He says, "Please send US $1 million from Winter Ally Investments Limited in May." This money was paid to Sino-Forest and the auditors did not require Sino-Forest to write off the remainder of the debt. No logs were ever delivered and the balance was never repaid.

[632] These examples of financial interactions between Mr. Chan and the owner of Sino-Forest's largest wood log supplier represent a small fraction of the evidence of relationships, not only with Lam, but with other wood log suppliers and customers, as well as evidence of relationships between the suppliers and customers themselves. All of this evidence further supports the inference that the counterparties to Sino-Forest wood log trading giving rise to the cash gap were not at arm's-length.

[633] I am satisfied that the preponderance of probabilities, having regard to all of the evidence, is that the wood log cash gap was a fraud orchestrated by Mr. Chan with the assistance of Inside Management at Mr. Chan's direction.

The Wood Log Deposit Fraud

Overview

[634] The plaintiff alleges that Mr. Chan and Inside Management caused a number of Sino-Forest's subsidiaries, using Sino-Forest's funds, to enter into wood log trading agreements and to

pay substantial unsecured “deposits” and “advance payments” to entities with undisclosed connections to Mr. Chan. The amount of the unsecured deposits and advance payments exceeded the value of any logs delivered. Following the Muddy Waters Report, essentially all log deliveries ceased and, with one limited exception, no repayment of outstanding deposits or advance payments was ever made. Through four transactions of this nature, (Prompt Sky, Trevista, Xunxiang and Elderbridge), Sino-Forest is alleged to have lost $167.4 million.[7]

[635] The defendant says the wood log trading model had a *bona fide* business purpose. Through log trading, Sino-Forest secured long term trading agreements at favourable prices. Although capital-intensive, it was a low risk endeavour because the balance of the contract price (after deposits and advance payments) was paid through trust receipts and letters of credit, which could only be drawn upon by the suppliers after logs had been delivered.

[636] Log trading was supportive of a PRC policy to promote timber imports to help alleviate the fiber supply deficit in China. And, log trading in Russia provided Sino-Forest with the chance to learn about the Russian market before making equity investments in timber concessions there.

[637] The defendant argues that losses in this business model were only incurred after the Muddy Waters Report. The wood log trading model only broke down when Sino-Forest could no longer obtain the necessary credit to cover its wood log trading transactions. This led to defaults when Sino-Forest was unable to make scheduled payments for log deliveries.

[638] The defendant denies that the counterparties to the wood log transactions were not at arm’s-length or that he, or others in senior management, controlled the counterparties in any way. Finally, the defendant argues that the loss, if any, was suffered by Sino-Forest’s subsidiaries, for which Sino-Forest itself has no claim.

[639] I have concluded that the scheme of causing Sino-Forest to fund these deposits and advance payments was a fraud, the effect of which was to divert Sino-Forest’s cash to entities secretly controlled by Mr. Chan or others acting under his direction.

[640] My reasons for this conclusion are set out below, in the context of reviewing each of the four transactions which the plaintiff alleges were fraudulent and caused a loss to Sino-Forest of $167.4 million.

Prompt Sky

[641] Mr. Chan admits that he caused Sino-Panel Trading, a Sino-Forest subsidiary, to pay Prompt Sky, a BVI company, $25.8 million as an unsecured deposit towards the purchase of wood logs under a supply agreement dated February 15, 2011. Mr. Chan signed the Prompt Sky Agreement on behalf of Sino-Panel Trading and Peggy Lo signed on behalf of Prompt Sky.

[7] This amount is before taking into account the $10 million RAPA recovery in respect of the Xunxiang transaction, discussed below.

[642] Similarly, there is no dispute that Mr. Chan caused Sino-Forest to fund the $25.8 million Prompt Sky deposit by authorizing Sino-Forest to lend Sino-Panel Trading the money to be paid to Prompt Sky. Mr. Chan signed the loan agreements on Sino-Forest's behalf; Ip signed them on behalf of Sino-Panel Trading.

[643] Mr. Chan testified that, at the time he signed the purchase and loan agreements on behalf of Sino-Forest, he:

(a) understood that the $25.8 million deposit was unsecured;

(b) did not know whether Prompt Sky had ever previously entered into a contract with any Sino-Forest entity;

(c) had no recollection of asking what due diligence had actually been performed;

(d) did not know what (if any) assets Prompt Sky had; and

(e) did not know who the principals were behind Prompt Sky.

[644] There is evidence that Ip asked Mr. Chan's sister, Pauline, which counterparty should be used for the transaction. Pauline Chan told Ip that Prompt Sky was to be the name of the counterparty. Ip then forwarded that information to his team and asked them to prepare the Prompt Sky agreement. This was on the same day that Mr. Chan executed the Prompt Sky agreement, February 15, 2011.

[645] At trial, Mr. Chan contradicted prior evidence he had given by admitting that he always knew his friends, Lam and Peggy Lo, were the sole shareholders of Prompt Sky. Mr. Chan's evidence at trial was that because Lam was involved, Mr. Chan had added comfort that Prompt Sky would not default on its obligations.

[646] Peggy Lo was a director and shareholder of Shiny Tech. Shiny Tech held both of Mr. Chan's residences in trust for Mr. Chan's daughters.

[647] Lam is a friend of Mr. Chan's. He is a former Sino-Forest employee and owner of China Square, a major wood log supplier for Sino-Forest. Lam made payments toward the purchase of Mr. Chan's residences. Yosanda instructed Peggy Lo to sign the provisional agreement of purchase and sale. She also told Lam to make the payments toward the purchase. Lam later accounted to Mr. Chan, through Yosanda, for these payments in a spreadsheet and email.

[648] A few days after the Prompt Sky agreement was signed, it was amended by Sino-Forest staff without any input from Prompt Sky.

[649] No wood was ever delivered under the Prompt Sky agreement and the deposit was never repaid. Further, during the time Mr. Chan remained at Sino-Forest, no one from Sino-Forest ever followed up with Prompt Sky about outstanding deliveries of logs or the return of the deposit.

[650] It was not until after Mr. Chan was required to resign that Sino-Forest wrote to Prompt Sky about its failure to deliver any logs. No response was ever received from Prompt Sky. Prompt Sky was struck off the register of companies in the BVI for non-payment of fees on November 1, 2013. Prompt Sky and Sino-Forest's $25.8 million simply vanished.

[651] Although admitting that Lam was his friend and that Lam was behind Prompt Sky, Mr. Chan testified he never spoke to Lam about recovering the $25.8 million or having Prompt Sky deliver the promised logs. It was only after New Plantations acquired Sino-Forest's PRC assets in 2016 that Mr. Chan says he had discussions with Lam about re-activating the contract.[8] No recovery of the deposit (or cash receipts of any kind) under this agreement has taken place under the RAPA.

[652] The logical and reasonable inference from these facts is that Prompt Sky was not at arm's-length from Mr. Chan. This was never disclosed.

[653] The outstanding deposit balance of $25.8 million was written off in Sino-Forest's books as unrecoverable in December 2011, resulting in a $25.8 million cash loss to Sino-Forest.

Trevista and Spring Field

Background

[654] In 2010, Sino-Forest was looking at forestry-related opportunities in Russia. Sino-Forest wanted to develop a full range of wood product development: plantations, harvesting, wood log trading and manufacturing. According to Ho, who was the senior manager responsible for overseeing this foray into the Russian forestry business, wood log trading was a good, low risk way to learn about operating in a foreign country.

[655] On July 1, 2010, Sino-Panel Russia (SPR) and Trevista entered into a long term supply agreement for the supply of Russian wood logs to SPR over a period of ten years (the Trevista LTS). Mr. Chan signed the Trevista LTS on behalf of SPR. Jack Chen signed on behalf of Trevista.

[656] Between July 1, 2010 and July 3, 2011, SPR entered into nine specific purchase agreements with Trevista under which Trevista was to supply SPR with various quantities of Russian wood logs. Mr. Chan signed the first agreement on behalf of SPR and Ho signed the remaining eight.

[657] A feature of the Trevista log purchases was that that every single purchase of logs by SPR from Trevista was matched, within four days, by a sale from SPR to Spring Field. Thus over the same period (July 2010 to July 2011) SPR entered into nine log sale agreements with Spring Field. Ho signed all nine of these sale agreements.

[8] No documentary or other support for this assertion was offered. How this would happen after so many years and the deregistration of Prompt Sky was not explained.

[658] Sino-Forest and SPR entered into a loan agreement under which Sino-Forest lent SPR $62 million to finance the anticipated unsecured deposit and advance payments to be made to Trevista. Mr. Chan signed the SPR Loan Agreement on behalf of Sino-Forest; Ip signed on behalf of SPR. Documents approving the $62 million fund transfer to SPR indicate that the purpose of the loan was to "inject funds from Sino-Forest to SP-Russia for Long Term Wood Supply Agreement."

[659] SPR ultimately paid $63 million in unsecured deposits to Trevista, by way of a $25 million deposit under the Trevista LTS, and $38 million as "Advanced Payments" under four of the nine specific agreements. SPR also paid an additional $10.3 million for alleged log deliveries that, for reasons that were not explained, were not drawn from deposits already made, bringing SPR's total payments to Trevista up to $73.3 million.

Incorporation of Great Eastern Development and Other Companies for Jack Chen

[660] According to Mr. Chan, Ho introduced Mr. Chan to Jack Chen, a Chinese businessman. Mr. Chan and Ho interviewed Jack Chen for a job in the summer of 2009. In October of 2009, they got Chen a job working for Pauline Chan as Executive Director at Eminens. Mr. Chan testified that, shortly thereafter, Chen "proved himself capable" and "was then ready to set up his own companies to start doing business in Russia."

[661] In early 2010, Yosanda and Elsa Kwok (Ho's secretary), assisted in establishing Great Eastern Development (GED). They obtained the incorporation of GED, equipped its Hong Kong office and set up GED's telephone and internet accounts. GED's Certificate of Incorporation and share certificate list Jack Chen as the sole shareholder. Elsa Kwok forwarded the incorporating documents to Zeng, Ho and Chen using "eminens" and other non-Sino-Forest email addresses. Zeng said he understood Chen was going to be making investments for Sino-Forest in Russia because Sino-Forest did not want to use its own name.

[662] On January 6, 2010, Ho sent an email to Yosanda (to Mr. Chan's attention) advising that Chen wanted an indemnity against liabilities because he was "only a nominee." The email says:

> Allen:
>
> I talked to Jack again and he is fine with the new arrangement. He would like to have a quick face to face meeting with you more for comfort purposes.
>
> He also wanted to confirm that even though the Russia project is the only project in the Newco for now, this does not preclude that there are other potential projects that can be developed as originally discussed during his employment in light of the fact that Eminens is currently managing the majority of the projects discussed originally.
>
> He also indicated that he does not mind being a shareholder of the Newco but would need some assurance of indemnity of liabilities, etc. as he is only a nominee. I will get John Zeng to draft some terms for your review.

[663] During his examination for discovery, Mr. Chan stated that he had no recollection of this email. He said that he had "no idea what [Ho is] talking about", and that "we haven't get into implementing that structure, so there's no Newco."

[664] Mr. Chan's explanation evolved during his examination at trial. He recalled that at some stage, he and Ho had requested Jack Chen's assistance in paying $10 million to secure an investment in a Russian company, PLP. This was a company for which, he said, Sino-Forest used Trevista (Jack Chen's company and a counter party to a large wood log trading contract) as an intermediary to "shield the identity of Sino-Forest, as the purchaser, and protect its interests." Mr. Chan speculated that this might be what Ho was referring to. This explanation, however, finds no support in the plain words of the text. It is also implausible, given that the email was sent in January 2010 and predates the first payment to Trevista by eight months. It also predates the incorporation of Trevista by six months.

[665] It is clear, in the context, that "Newco" is a reference to GED. It is also clear that Ho was not contemplating that Jack Chen would be operating that company as an arms' length wood log trading counterparty. Rather, the email contemplates that Chen would be a "nominee," hence the need to address Chen's concern to be indemnified against possible liability. The $10 million so-called "investment" in PLP on behalf of Sino-Forest was never disclosed to Sino-Forest or its Board. Ho admitted as much.

[666] During cross-examination it was put to Mr. Chan that Ho clearly thought Jack Chen was only acting as a nominee. Mr. Chan then testified that Ho was mistaken and that that Jack Chen was supposed to be "an agent" of Sino-Forest. There would not be "any nominee arrangement between Sino-Forest and Jack Chen's company," according to Mr. Chan.

[667] Even accepting this evidence on its face, it would have been a serious conflict were Jack Chen's company to be, simultaneously, Sino-Forest's "agent" and also SPR's arm's-length third party log supplier and customer. In cross examination, however, Mr. Chan rejected the suggestion that these functions were mutually exclusive:

> As I said earlier that he is there to perform two kinds of function. One is in terms of trading. So for that part, it is that is a third-party definitely a trading thing.
>
> And then the other is to perform the function help us to spearhead into the acquisition of Russian Projects. At that point of time we haven't decided what exactly should be the format, the eventual structure of the deal.

[668] Mr. Chan expanded further on Jack Chen's role during the following exchange:

> Q.…Now I think I understand where you're coming from. You're suggesting when Jack Chen and his newly incorporated companies are acting as a log supplier, or a log customer, because they were both, to Sino-Panel Russia, they were acting as independent third-party counterparties. But when that same Jack Chen was operating his Newco to go out and look for a potential acquisition target, he was

> following your instructions and not accounting as an independent third party; is that right?
>
> A. He is independent third party but performing the kind of generic what we are calling agent.
>
> Q. Sometimes Jack Chen was wearing his independent log supplier hat, sometimes he was wearing an independent log customer hat, and sometimes he was wearing his company acquisition agent hat?
>
> A. That is exactly the kind of arrangement you needed into Russia.

[669] Mr. Chan's explanation regarding the many roles purportedly played by Jack Chen is unsupported by the contemporaneous documents and is not credible. The simpler and more plausible explanation is that Jack Chen only had one role: acting as Mr. Chan's nominee.

[670] Ho also sought to resile from the plain meaning of his email. Ho, however, testified that when he used the word "nominee" what he really meant was "firewall":

> But I guess if Jack becomes a shareholder of a company that deals with Sino-Panel, in my mind, he would be acting as a firewall for Sino-Forest because he would be at the front to shield Sino-Forest with respect to the dealings in the Russia arena, which, you know, neither -- I guess at least myself, I don't know whether Jack knows Russia that much, but I guess in my mind, he is saying that he is acting as a firewall for Sino-Forest, so he requires indemnity of liabilities. So I -- "as he is only a nominee" -- in my mind, I used "nominee" because he is just a firewall between Sino-Forest and our Russian counterparts. Analogy is Yuda being a firewall between us and the local farmers. So in my mind, at that point in time, I would have meant -- and what I read this to mean, that he is the firewall between Sino-Panel group of companies doing business with Russian counterparts.

[671] Ho's concept of a "firewall" is inconsistent with the indemnity discussed in his email to Mr. Chan. Sino-Forest would not indemnify an arm's-length trading partner from liability if the whole reason for using the trading partner was to protect Sino-Forest from the liability to which the trading partner might be exposed.

[672] Ho's email to Mr. Chan, authored in the normal course of business, when he had no reason to lie, is compelling contemporaneous evidence of a plan to use Jack Chen as Mr. Chan's nominee to conduct undisclosed related-party wood log trading at Sino-Forest's expense.

[673] Mr. Chan's financial interest in GED is also reflected in a March 19, 2010 text message sent to Yosanda, just as Project Russia was ramping up. That text, referred to earlier, says:

> We need rmb 5 m for jack's hk ged. pls send him the funds. I have talked to allen and yosanda is copied with this sms.

[674] A reconciliation sent by Marco Lam to Yosanda shortly after this text corroborates a payment to Jack Chen of HKD$5 million made on March 22, 2010 (three days after the text message), organized by Lam through a company named Day Best. Day Best re-emerges in the nominee narrative outlined below.

[675] Several more GED-related, Jack Chen companies were incorporated as part of what Ho called Project Russia. In August 2010, Tiffany Chen forwarded Ho and Jack Chen "registration information of the BVI companies as at 13 August." Ho and Tiffany Chen were using the Eminens email platform. The list of companies includes Trevista, Trellis and Spring Field.

[676] Ho forwarded this list of the companies "involved in the Russia project" to Yosanda at her Yahoo email address. Ho told her he would update the list "from time to time as the flow stabilizes." Ho told Yosanda that Zeng had helped incorporate each one of these companies. Zeng testified that he did not incorporate these companies but that his firm, Kai Tong, did act for Jack Chen providing administrative assistance to set them up. Zeng understood they were all Chen's companies. According to Zeng, he acted for Chen in helping to set up these companies and, later, in reviewing their structure.

[677] In early 2011, there was further correspondence about the Project Russia companies between Zeng, Zeng's associate, Kelly Xie, Jack Chen and Colin Wong, who Zeng said was a Sino-Forest employee, all using non-Sino-Forest email platforms. Attached to this correspondence is what is described as a complete list of "non SF companies for Project Russia which KT was responsible for setting up." The email asks Zeng to provide a brief description of the current status of these companies so that "we" have a complete list to keep track of. On Zeng's behalf, Kelly Xie confirmed the information was current.

Jack Chen Reported to Mr. Chan

[678] On April 17, 2010, Jack Chen sent an email to Yosanda setting out "some quick updates for Allen." Jack Chen reported to Mr. Chan on his progress in implementing assignments for GED and concluded the email by stating:

> Please let me know for any comments. Since I am new in the project and I am outside of Sino, I would appreciate more helps and instructions directly from Allen, if possible, until I understand better Allen's thought and way of working among the team in order to better serve the company.

[679] When confronted with the email during cross-examination, Mr. Chan asserted that Jack Chen was merely trying to get Mr. Chan's attention and seek his "thoughts." Mr. Chan maintained that Jack Chen was mistaken when he referred to seeking "instructions" from Mr. Chan.

[680] Another email from Ho, with the subject line "Request for a meeting", was sent to Yosanda on March 2, 2011, and forwarded to Mr. Chan on his Blackberry the same day. In the email, Chen had requested that an agenda item be added called "directions for the business

management (GED group) for going forward." Chen also undertook to "send Allen and George the financial report of Jan later."

[681] During cross-examination, it was put to Mr. Chan that it did not make sense for Jack Chen to be seeking directions for the business management of the GED Group, given it included an arm's length supplier (Trevista) and an arms' length customer (Spring Field). Mr. Chan's answer was evasive. Ultimately, Mr. Chan's evidence was that, at that point, Chen was no longer needed for their Russia transactions and so was feeling "insecure …about his future." Mr. Chan's answer was not responsive, however. He could not explain why Chen would be seeking directions from Sino-Forest about the business management of an arms' length wood log supplier or customer and offering to provide to Sino-Forest the financial results of those arms' length entities.

[682] Two days after the above email, Jack Chen sent Mr. Chan (via Yosanda) and Ho the GED Group's January 2011 management accounts as he had undertaken to do. These management accounts include accounts in respect of Trevista, Spring Field, and Trellis. On his examination for discovery, Mr. Chan stated that he did not know why Jack Chen sent Ho the accounts, stating "we have to ask George Ho." Asked again on cross-examination, Mr. Chan speculated that Chen sent these accounts because he was "trying to establish the comfort that he is trustworthy."

[683] Mr. Chan also denied that it made no sense for Jack Chen to be running both Trevista, the supplier to SPR, and Spring Field, SPR's customer, since it meant Jack Chen was selling logs to Sino-Forest and then buying them back days later at a mark-up. Mr. Chan was unwilling to accept that this was suspicious. He speculated there might be "tax reasons" for such an arrangement. Ho's testimony, when asked about the dual-role of Chen's companies as both SPR supplier and SPR customer, was also incomprehensible.

[684] Ho, in response to a question from defence counsel in re-examination about the apparent contradiction of the GED Group, supposedly at arms' length from Sino-Forest, selling to Sino-Forest and then buying back the same logs at higher prices, said that he thought Jack Chen was trying to hide from Sino-Forest who his real customers were. When Ho was then asked why Trevista would not simply sell directly to the end customer, and leave Sino-Forest out of it, Ho replied:

> I think probably they did not have the money or cash to pay for the supply – sorry, the purchase of Russian timber.

[685] This answer sums up, in a nutshell, the convoluted, internally inconsistent, even nonsensical, nature of the defendant's attempted explanation for the structure of these wood log trading transactions. Ho seems to be admitting that Sino-Forest was bankrolling what was supposed to be GED's arm's length trading operations. Implicit in Ho's answer is that Jack Chen wanted to sell logs to an unidentified third party and did not want Sino-Forest to know who it was. To do this, Jack Chen's company sold logs to Sino-Forest, Sino-Forest sold the same logs to Jack Chen's company Spring Field for a small markup, and then Spring Field sold the logs on to the unknown entity that Jack Chen wanted to sell to. Ho could not explain why Jack Chen would not

just buy the logs and sell them directly to his intended customer. His assertion that Jack Chen's company probably did not have any money, while possibly true, does not explain why Jack Chen could not have obtained deposits or advanced payments from his customers just as he did from Sino-Forest. On the evidence, these transactions lacked any commercial purpose.

[686] Ho was equally unable to provide a plausible explanation of why Chen sent him the January 2011 financial reports for Trevista, Trellis and Spring Field. Ho suggested that the figures for Trevista and the other companies were included "to demonstrate the flow of the transaction or flow of logs." Ho's answer did not explain why Sino-Forest needed that information or why a company purportedly at arm's-length to Sino-Forest would reveal the "flow" of its transactions to its opposite party in those transactions.

[687] The January 2011 accounts provided by Jack Chen to Mr. Chan and Ho also reflect that Trevista had an account receivable of $1 million from Day Best. When asked what he knew about Day Best, Mr. Chan claimed "I have no idea, and it is not my company." Day Best, however, is the company:

a) through which payments were made to Mr. Chan's solicitor, May Tsui, with respect to the purchase of Mr. Chan's Hong Kong residential properties held by Peggy Lo in Trust for Mr. Chan's daughters. These payments were arranged by Lam, who provided Yosanda with a payment reconciliation reflecting funds coming into and out of Day Best; and

b) through which funds were paid to "Jack's HK GED" following discussion with Mr. Chan, again arranged by Marco Lam, and also reflected on the Day Best payment reconciliation sent to Yosanda.

[688] Another representative of GED, Wang Johnson, sent Ho (with a copy to Jack Chen) a purchase plan for Trevista on April 20, 2011, under cover of an email summarizing various amounts "we need to pay." Johnson's message also asks for more money from Sino-Forest under the purchase agreement to cover its expenses.

[689] One of the attached spreadsheets to Johnson's email, with the filename "Reconciliation with SINO.xls," includes a chart entitled "Status of BVI Capital Injection" for the period ended on March 31, 2011. The chart records as a "cash injection" all of the deposits and advance payments made by SPR under the Trevista LTS (i.e., totalling $63 million), less a deduction for a $14.9 million "Payment to SP Russia." The spreadsheet records as "cash usage" an assortment of payments to various payees, many of which appear to have nothing to do with wood log trading in Russia under the LTS. These include a $299,000 "consultancy fee" to Kai Tong (John Zeng's law firm), a $1.3 million "consultancy fee" to One Word (a company associated with Lam) and a $1 million "consultancy fee" paid to Day Best, also Lam's company.

[690] During cross-examination it was put to Ho that Johnson had treated the payments made by Sino-Forest under the Trevista supply agreements as a "capital injection." Ho dismissed this as a

Chinese language issue, explaining “Johnson is a Chinese accountant…he is just trying to tally the cash that came from [SPR] for those couple of lines.” Ho was unable to explain why GED, if it was an arms’ length company, was explaining to Sino-Forest how it was spending the money it earned on arms’ length trading revenues.

[691] It is clear that the “Status of BVI Capital Injection” accounts effectively treated Trevista, Spring Field and other companies in the GED Group as one company, with SPR’s deposits and advanced purchases for logs being treated as a capital injection (net of the payments made by Spring Field to buy back the same logs). This is not a reconciliation so much as an accounting of where the cash furnished by Sino-Forest had been spent by the various entities Jack Chen supposedly controlled. Ho initially conceded that Trevista, Spring Field and Trellis were all Jack Chen’s companies. He then resiled from that concession, once he was reminded that Sino-Forest appeared to be buying from and selling the same logs to effectively the same person. Ho’s evidence changed with every shift in the wind. His explanations were inconsistent, internally contradictory and lacked any “ring of truth.”

Altered Bills of Lading

[692] The plaintiff, as the post-CCAA Plan custodian of all of Sino-Forest’s records, testified in his pre-filed evidence in chief that he had been unable to find any reliable evidence that any wood logs were ever supplied by Trevista to SPR or delivered by SPR to Spring Field.

[693] Ho challenged this assertion in his evidence for the defence, asserting that SPR “should be in possession of the bills of lading to demonstrate the chain of custody of logs purchased from Trevista.” Ho appended to his affirmation a series of nine bills of lading “as an example of the bills of lading” that should be in the possession SPR. Ho explained the sample bills by reference to a shipper, RFP, and consignee, Suifenhe, stating “it is my understanding that Trevista purchased logs from the consignee and sold them to Sino-Panel Russia under the LTS.” Mr. Chan took the position in his opening at the outset of trial that the plaintiff’s inability to find independent evidence that logs had traded in the Trevista transactions “is bizarre given that Sino-Forest records contain bills of lading for the delivery of logs such as the bills of lading attached to the affirmation of George Ho.”

[694] As a result of Ho’s testimony, Mr. Borrelli conducted further searches of the document database for bills of lading. Mr. Borrelli found substantially identical copies of seven of the bills of lading appended by Ho to his affirmation. The bills of lading appended to Ho’s affirmation and those located by Mr. Borrelli in Sino-Forest’s records, while otherwise identical, differed in two respects:

(i) the dates on the bills produced by Ho all show August 12, 2010, whereas the dates on the bills in Sino-Forest’s records are all in July 2010. The date is important because August 12, 2010 is the date funds first flowed under the Trevista LTS; and

(ii) some of the bills from Sino-Forest's records identify an associated contract and the dates of those contracts predate (in some instances by years) the Trevista LTS. In the bills appended to Ho's affirmation, the contract numbers and contract dates appear to have been whited out.

Counsel for Mr. Borrelli argues that these alterations were deliberately made to obscure the fact that the real bills of lading had nothing to do with Trevista and to give the false impression that these bills of lading related to, or might have related to, the Trevista transactions.

[695] At trial, in the face of Mr. Borrelli's evidence suggesting document tampering, Ho sought to distance himself from the bills of lading attached to his affirmation. During his examination-in-chief, Ho testified that he had obtained the bills from Alex Lin, a former subordinate at Sino-Forest, who, he said, in turn had obtained them from Sino-Forest's records during the OSC hearings. The bills of lading attached to his affirmation, he emphasized, were never meant to do more than exemplify the "types" of bills of lading which he thought should be found in Sino-Forest's records in relation to Sino-Forest's transactions with Trevista and Spring Field.

[696] During his cross-examination, Ho was taken through a comparison of the two sets of bills and it was put to him that someone had altered the bills appended to his affirmation. Ho maintained that "these are bills of lading between two separate companies or entities that has nothing to do with [SPR] and/or Trevista … it just puzzles me why we would like to forge this or whoever forged this or the allegations…"

[697] A careful comparison of the original bills of lading produced by Mr. Borrelli from Sino-Forest's records and the attachments to Ho's affirmation leaves me in no doubt that they are exactly the same documents with two alterations. The attachments to Ho's affirmation have had the contracting party whited out and the dates of the documents have been changed from July 2010 to August 2010. Ho's original affirmation effectively accuses Mr. Borrelli of not being forthright, or at least being incompetent, in his review and production of bills of lading. This is in particular directed to Mr. Borrelli's statement that there he found no reliable evidence than any logs were ever delivered by Trevista or to Spring Field. Ho says: "Sino-Panel (Russia) should be in possession of the bills of lading to demonstrate the chain of custody of logs purchased from Trevista." He then refers to the altered bills of lading attached to his affirmation.

[698] It must be concluded that Ho, or someone acting on his instructions, altered the bills of lading and then put them before the Court as genuine. Ho's alteration of the bills of lading can only be viewed as a veiled attempt to validate the legitimacy of the Trevista transactions by making the bills of lading attached to his affirmation appear to be dated at a time when the Trevista purchase agreement was extant and by removing the real counterparty's names which made it obvious that these documents had nothing to do with Trevista. While it is true that they were only presented as "examples," the obvious alteration of the documents, if nothing else, casts serious doubt on the reliability and credibility of Ho's evidence.

Project Russia on the Nominee Company Managers List

[699] GED, Trevista, Spring Field, and Trellis all appear on the Nominee Company Managers List under Project Russia with Ho and Jack Chen listed as the managers. The “Documentation Signed by Nominee Shareholder(s)” column has a checkmark for 13 of the 15 companies under Project Russia.

[700] The Nominee Company Managers List records Jack Chen as director and shareholder of GED with an incorporation date of January 4, 2010. Chen Teng is recorded as the director/legal representative of seven other companies on the same list under Project Russia and the sole shareholder of Max Grand. Max Grand holds shares in the remaining six companies of which Chen Teng is a director.

[701] Chen Teng and Tiffany Chan are the same person. She worked at Eminens for GED. The “list of companies involved in the Russian project” that Ho sent to Yosanda (described above) was first sent to Ho by Tiffany Chan. The attached list of companies included Trevista, Trellis, and Spring Field, as well as many other companies listed under Project Russia on the Nominee Company Managers List.

Conclusion on Trevista Deposits and Advance Payments

[702] I have concluded, on all the evidence, that Jack Chen operated GED, Trevista and Spring Field under Mr. Chan and Ho’s authority and direction as Mr. Chan’s nominee. GED, Trevista and Spring Field were not arm’s length companies. Mr. Chan and Ho knew this.

[703] Mr. Chan secretly controlled Trevista and Spring Field and caused Sino-Forest to advance millions of dollars to Trevista, and take on similar obligations from Spring Field, all of which had no real commercial purpose.

[704] These transactions were, in fact, conducted for the purpose of diverting cash from Sino-Forest to these entities that were controlled by Mr. Chan, for the purpose of benefitting Mr. Chan and his associates.

Sino-Forest’s Loss

[705] As set out in the Steger Report (dealt with below), Sino-Forest suffered an actual cash loss of $46.759 million in connection with the Trevista log trading transactions representing:

a) the Trevista deposit balance outstanding of $23.3 million which was written-off in December 2012; together with

b) unpaid receivables from Spring Field of $24.9 million, which was written off in December 2011; less

c) the portion of the unpaid Spring Field receivables that exceeded the amounts paid to Trevista in connection with the same purported logs, (i.e. fictitious paper profits, which the Litigation Trust does not claim as a loss) of $1.501 million.

[706] Mr. Chan's damages report from Mr. Ratner refers to Ho's evidence when asserting that Sino-Forest failed to take timely action to recover its deposit and suggests the delay in pursuing recovery of the deposit was the likely cause of the loss.

[707] Ratner's analysis trenches on questions of liability and purports to assess the evidence in relation to the alleged fraudulent dealings. In this respect, it exceeds the appropriate scope of an expert on damages. In any event, Ratner ignores Ho's close working relationship with Jack Chen and how deeply involved Ho was in the undisclosed related party transactions between Trevista, Spring Field and SPR. As fiduciaries, both Mr. Chan and Ho had clear duties to disclose to the Board and the IC the circumstances in which Sino-Forest's money was paid to Trevista, including the $10 million apparently paid to PLP. Neither of them did so.

[708] The defendant argues that the loss of the deposit is the result of Sino-Forest's delay in seeking recovery until 2012. However, Mr. Chan and Ho were fiduciaries. They were deeply involved, I find, in conducting undisclosed related party transactions with Trevista, Spring Field and others. They had a clear duty to disclose these conflicts at the time to the Board and later to the IC and the Monitor. Their failure to do so left independent management in the dark about the nature of the problem.

[709] Further, Ho admitted on cross-examination that he actually recommended writing off the balance of the Trevista deposit and advance payments in a report dated March 26, 2012 (just two weeks before he and Mr. Chan were terminated). The fact that Ho recommended writing off the deposit further shows that Sino-Forest's inability to recover the deposit was not the result of any failing on the part of new management post-Muddy Waters Report.

[710] Instead, the fault lies with Mr. Chan and Ho, who authorized the unsecured payment to Mr. Chan's nominee's company, Trevista, of tens of millions of dollars in purported deposits and advance payments for logs that were never, and never intended to be, delivered.

Elderbridge

Overview

[711] Sino-Forest paid a $10 million deposit to Elderbridge for the purchase of logs from Inner Mongolia. Elderbridge was controlled by Jim Lok, who later transferred the shares, and his directorship, to Marco Lam. Yosanda arranged for the incorporation of the Elderbridge companies and looked after their administration and regulatory filings. Yosanda prepared the documents for the change of ownership and control from Lok to Lam. Elderbridge is listed as a nominee company on the Nominee Company Managers List.

[712] The 2006 supply agreements required the return of the deposit if log deliveries did not take place. Although no log deliveries took place, no repayments of the deposit took place until Sino-Forest's auditors threatened to write off the account receivable in 2011.

[713] At that time, Hung told Lam to make a $1 million payment and it was made within days. The remainder of the account receivable was, as a result, left on Sino-Forest's books. No further payments were ever made.

[714] The evidence leads to the clear inference that Elderbridge was not arm's length and that it was controlled by Mr. Chan. The evidence also supports the inference that the entire transaction was set up as a means of diverting millions of dollars out of Sino-Forest into entities secretly controlled by Mr. Chan and his associates. This transaction resulted in a $9 million loss to Sino-Forest.

[715] The plaintiff alleges that Mr. Chan caused Sino-Forest to fund its subsidiaries to pay $10 million in unsecured, interest-free deposits to Elderbridge, purportedly for the long-term supply of logs from Inner Mongolia. Few, if any, logs were ever delivered to the Sino-Forest Group under this supply arrangement. Ultimately, only $1 million of this deposit was repaid to the Sino-Forest Group, resulting in a loss to Sino-Forest of $9 million.

The Transaction

[716] There is no dispute that Mr. Chan authorized the transfer of $10 million from Sino-Forest to Sino-Wood on March 14, 2006. Sino-Wood then paid $9.5 million to Elderbridge, and another Sino-Forest subsidiary paid $0.5 million to an equity joint-venture (the "EJV"). Mr. Chan signed various documents authorizing the payments.

[717] The $9.5 million deposit was made on April 25, 2006, more than three months before a long term supply agreement was signed on July 30, 2006. Mr. Chan was unable to explain the reason for this timing. The Agreement relating to the $9.5 million deposit, however recognizes that the prepayment was made "to evidence [Sino-Wood's] good faith in negotiating with the EJV the Master Agreement."

[718] The $9.5 million deposit agreement provided for Elderbridge's parent company to create a fixed charge over its shareholding in Elderbridge in favour of Sino-Wood as security for the deposit. No charge was ever created.

[719] Despite the supplier's failure to deliver wood logs or return the deposit in accordance with the relevant agreements, neither Mr. Chan nor Sino-Forest took any meaningful action to enforce Sino-Forest's rights to the delivery of the wood logs or the return of the deposit.

[720] Elderbridge and the EJV were connected to Mr. Chan through Jim Lok. In his examination for discovery and again under cross-examination, Mr. Chan acknowledged that Elderbridge was in "Jim Lok's group", that "the transaction was with Mr. Lok." Mr. Chan

acknowledged he discussed with Lok arrangements for the long-term supply of wood from Inner Mongolia before entering into a Long Term Supply Agreement with Elderbridge.

[721] The EJV is listed on the Nominee Company Managers List with Jim Lok listed as the Manager. Elderbridge is listed as the 95% shareholder of the EJV.

[722] Yosanda first selected the names of Elderbridge and Findhelm (Elderbridge's holding company) in September 2005, to be used in an earlier project called "Project Khan." Yosanda's evidence at trial was that Lok asked her to purchase these companies. However, there is no documentary evidence of such a request coming from Lok.

[723] Yosanda periodically received emails (e.g. in May 2008 and February 2011) and invoices (e.g., in March 2008) from Panocean Secretarial Services relating to matters affecting both Elderbridge and Findhelm. This included invoices for the payment of annual licence fees and registered agent/office fees. Yosanda managed the corporate administration of these companies.

[724] Yosanda sent an email in March 2009 to Lok's secretary requesting Lok to provide identification documents for Tsui Yan (Lok's business partner) in order to meet regulatory requirements for Elderbridge and Findhelm.

[725] Mr. Chan's explanation for why his secretary at Sino-Forest, rather than Lok or Lok's assistant, were looking after the administration of Lok's supposedly arm's length company was that Lok was based in Shanghai. Mr. Chan did not explain why being in Shanghai had any bearing on Lok's ability to manage his own business interests or companies. Nor did he explain why Lok would entrust these matters to an employee of a Sino-Forest counterparty whose interests were not the same as, and potentially adverse to, Elderbridge.

[726] There are also documents sent from Hung to Lok in which Hung asked Lok to look after getting signatures on Findhelm resolutions relating to an instrument of transfer and resignation and to return the originals to him. The required documents were provided by Lok to Yosanda several days later.

[727] Between 2006 (the year that the Elderbridge Long Term Supply Agreement was executed) and 2010, few (if any) wood logs were supplied. Even though the $9.5 million deposit agreement provided that, if logs were not delivered, Elderbridge was required to repay 20% of the $9.5 million deposit each year, no such repayments were ever made.

[728] One excuse advanced for why no logs were delivered was due to the imposition of a Russian export tax which made it uneconomic for Elderbridge to make actual log deliveries. While this may be true, it does not explain why the deposits were left with Elderbridge for 5 or 6 years with no action. Indeed, if it were obvious the supplier was not going to deliver due to prohibitive export taxes, there was all the more reason for Sino-Forest to insist upon return of the deposits until the tax situation improved.

[729] There was an increasing level of concern raised by Sino-Forest's auditor, E&Y, between 2007 and 2010 regarding Elderbridge's failure to repay the deposit and the EJV's failure to deliver wood logs in accordance with the relevant agreements. During cross-examination, Mr. Chan acknowledged that there had been "management concerns" and that "the auditor raised concern" about the fact that wood logs had not been supplied and the deposit had not been returned.

[730] Despite these concerns, Mr. Chan did nothing to enforce Sino-Forest's rights regarding the repayment of the deposit or the delivery of wood logs to its subsidiaries. In his examination for discovery, Mr. Chan confirmed that he never personally discussed the return of the $10 million deposit with his friend Lok, because "[i]t's too small a deal."

[731] In August 2010, the Elderbridge supply agreement and the $9.5 million deposit agreement were restructured to replace the parties associated with Lok with new parties associated with Lam.

[732] Mr. Chan signed the agreement terminating the $9.5 million Elderbridge deposit agreement and signed a fresh agreement under which Sino-Wood agreed to pay a $9.5 million deposit to Winner Ally. Although on the face of these agreements, the $9.5 million deposit should have been returned to Sino-Wood, and then an equivalent sum should have been paid to Winner Ally, there is no evidence that this receipt and payment ever occurred.

[733] The key counterparties to the restructured transaction were Erenhot Quande and its parent company Winner Ally. Both companies appear on the Nominee Company Managers List as being companies managed by Lok.

[734] However, in May 2010, the ownership of Winner Ally was transferred from Lok to Lam. The restructuring of the Elderbridge deposit consisted of Lam stepping into the shoes of Lok as shareholder and director of Winner Ally and Erenhot Quande.

[735] It was Yosanda who provided draft resolutions removing Lok as a director of Winner Ally, replacing him with Lam and transferring ownership of Winner Ally from Lok to Liang Tai (a company controlled by Lam) for consideration of $1 million. Yosanda sent these documents to Lok's secretary to arrange signatures and asked them to "return the originals to me."

[736] It was Hung who confirmed that Liang Tai was the parent of Winner Ally and asked Lam to have the Erenhot, Winner Ally and Liang Tai contracts signed.

[737] The Winner Ally deposit agreement provided that the $9.5 million deposit was to be repaid to the relevant Sino-Forest Group member by way of regular installments. The first installment was due in May 2011.

[738] During the 2010 financial statement audit, Sino-Forest's auditors indicated that if the May 2011 initial repayment of the deposit of $1 million was not made, the account receivable would be reassessed. On May 11, 2011, Horsley asked Mr. Chan to follow up on this payment, otherwise E&Y would require Sino-Forest to write off the whole $10 million. Mr. Chan sent this email to Hung who replied that he would "work with" Lam.

[739] Hung then emailed Lam asking for the money and telling him to make the payment from Winner Ally. Within a few weeks, $1 million was paid to Sino-Forest.

[740] The ease with which Mr. Chan was able to procure the repayment of $1 million when required, in the circumstances, is strong circumstantial evidence that he executed control over Lam's companies and the deposited funds. No repayments of this deposit had taken place for five years, and no repayments were made after this, in spite of the fact that no logs were delivered. This too is further evidence that the supply contract and deposit agreement were not *bona fide* commercial transactions.

[741] The Sino-Forest Group received no further payments with respect to the outstanding $9 million deposit. The outstanding balance of $9 million was written off in Sino-Forest's books as unrecoverable in September 2012, resulting in a $9 million cash loss to Sino-Forest.

Xunxiang

[742] With respect to wood log contracts entered into with Xunxiang, it is alleged that Mr. Chan, together with members of Inside Management, secretly controlled Guangxi Xunxiang Timber Import & Export Company Limited ("Xunxiang"), which was a wood log supplier to Sino-Forest.

[743] Sino-Forest paid substantial unsecured deposits to Xunxiang resulting in a loss to Sino-Forest of at least $85.8 million in cash (prior to taking into account payment of approximately $10 million received under the RAPA).

[744] There are four contracts in particular which found the basis for the plaintiff's allegations. The four wood log supply contracts do not clearly identify which of the three Xunxiang companies was Sino-Forest's counterparty. According to Mr. Chan's evidence at trial, "it should be the Hong Kong or BVI company" but that "I'm just confused myself about this." There are three companies all with the name "Guangxi Xunxiang Timber Import & Export Company Limited" registered, respectively, in the PRC, Hong Kong, and the BVI. The PRC incorporated Xunxiang is listed on the Nominee Company Managers List with Li Hai Bo as its manager, legal representative and as a 20% shareholder. Mr. Chan gave evidence at trial that all three Xunxiang companies were represented by his friend, Li Hai Bo.

[745] It is not in dispute that Sino-Forest's subsidiaries paid substantial unsecured deposits and balance payments totalling $87.6 million to Xunxiang under the four log contracts. The deposits and balance payments were largely funded by Sino-Forest through a complex series of intercompany loans.

[746] Sino-Forest received only $8.8 million of log deliveries from Xunxiang under the four contracts. Furthermore, as with Trevista, only a portion of the delivery price for these logs was actually applied against the deposits already made. Of the $8.8 million, only $1.8 million was taken from the deposits already made, while $7 million was paid for with a further cash outlay by Sino-Forest.

[747] The Xunxiang wood log deliveries were on-sold by Sino-Forest to Trade Allied. Trade Allied never paid in cash for the majority of these logs. Instead, most of the accounts receivable were settled via set-offs against BVI standing timber purchases of $8.3 million in March 2011. Only $0.9 million was actually received as a cash payment.

[748] A number of documents reveal that Sino-Forest employees were significantly involved in the management of Xunxiang and drafted documents on its behalf.

[749] Ip regularly received Xunxiang’s balance sheets and information regarding the salaries paid to its employees, including Li Hai Bo.

[750] Certain Sino-Forest employees were also kept apprised of other internal Xunxiang matters. For example, Ip and another Sino-Forest employee were copied on an email dated April 8, 2011 sent from Jill Tsang at a Xunxiang email address to Li Hai Bo. Jill Tsang confirmed she had carried out Li Hai Bo’s instruction to transfer $6 million to his personal Cambodian account and confirmed that she was in the process of remitting a further $7 million as instructed during a call.

[751] Sino-Forest employees also drafted Xunxiang documents, including invoices and contracts. For example in January 2010, Lam (China Square) asked Brian Cheung (Sino-Forest) to prepare the contracts by which China Square would purchase logs from its supplier (i.e., contracts not involving Sino-Forest). Lau, Ip and Hung were all copied on this email. A few days later, Cheung sent Lam copies of a contract between Xunxiang and China Square. Cheung advised Lam that Xunxiang, China Square’s supplier, was a BVI company and that “payment terms have been changed to 40% deposit, balance by COD.” In another email exchange, Cheung is shown to be drafting and revising *Xunxiang’s* invoices to Sino-Forest for internal review and approval by other Sino-Forest employees.

[752] Xunxiang was also involved in a chain of transactions with China Square and Bohu. Both of these companies appear on the Nominee Company Managers List.

[753] China Square is undisputedly Lam’s company; it was a major wood log supplier to Sino-Forest. Lei could not recall whether he held shares in Bohu but he is recorded on the Nominee Company Managers List as a 50% co-owner of Bohu. Lei is also recorded as Bohu’s sole director. Pauline Chan is listed as Bohu’s manager.

[754] Hung, James Lau (“Lau”), and Mr. Chan were all examined on an email dated March 31, 2010 from Brian Cheung (Lau’s subordinate), to Hung, Lau, Ip, and Li Hai Bo. Cheung’s email attached “the latest” transaction flow chart together with a process chart.

[755] The flow chart depicts logs originating from a Vietnamese supplier being sold to Xunxiang and in turn sold at a profit of 1% to either China Square or Bohu. The logs are then shown to be sold at a profit of 20% to Sino-Forest Resources or Sino-Panel Asia and thereafter sold to Trade Allied (a wood log customer) at a profit of 4%. From there, the logs are shown to pass either to

Shenzhen Hongji (Lei's company) or an unknown party, with the "Profit:TBD" before ultimately being sold to a PRC customer with "Profit TBD."

[756] The chart also reflects different Sino-Forest personnel as being the "Person in charge" for various steps in the supply chain, including between the suppliers, Xunxiang and Bohu, and the customers, Trade Allied and Shenzhen Hongji.

[757] Another document attached to the email is a process chart that identified the person in charge for each transaction. The last key point indicates that where the actual price differs from the forecast price, the marginal increases are to be allocated to China Square and Bohu, not Sino-Forest. It states:

> Since the quality and quantity of each purchase influence the actual purchase price, the actual purchase price stands a good chance of being different from the contract price (usually lower than the contract price). In such case, the difference should stay in the upstream company of Sino (SFR/SPA), i.e. (CS/BOHU), and the sales price to the downstream company (TA) would not change.

[758] At trial, Mr. Chan denied any knowledge of the flow of log transactions depicted in the chart and could not explain why Ip, who had the relationship with Li Hai Bo and could enter into contracts directly with Xunxiang, needed to insert China Square as a middleman receiving a 20% profit. Mr. Chan could only say that it:

> seems a proposal about a complicated structure to resolve all those logistics of import/export and re-enter port arrangements. So it's complicated. It looks like a proposal. And are all the parties… have all the parties agreed on it? We just don't know.

[759] When shown evidence that Sino-Forest employees were drafting contracts and invoices between Bohu and Xunxiang, Mr. Chan agreed that Sino-Forest employees would not normally be drafting contracts to which Sino-Forest was not a party. All he could say was that he was "holding his position until I can find out what that is."

[760] Hung's evidence when cross-examined on the flow of logs chart, was that Sino-Forest employees were "simply providing assistance with the documentation required in the process of customs clearing." Hung thought the references to profit margin were simply "an estimate on the profit margin of each individual company." In Hung's view, the flow chart was "a proposal for the flow of the timber, so that all the colleagues who got involved with the flow of the goods would know where to provide assistance, or how."

[761] Hung was also asked about the last sentence of the process chart attached to the email which instructed that any marginal increase in actual profit be allocated to Bohu or China Square, not Sino-Forest. Hung said that an arm's length counterparties' profit margin was none of Sino-Forest's business.

[762] Lau was also cross-examined on Cheung's March 31, 2010 email and attached flow chart, along with a number of other emails to which he was a party that depicted Sino-Forest personnel preparing documents on behalf of Xunxiang. Despite being emailed the chart, Lau was unable to recall it and denied any involvement in it.

[763] The contemporaneous documents are not consistent with the characterization of the flow chart as a mere proposal. Sino-Forest employees prepared actual contracts between Xunxiang and China Square that correspond to the flow chart. Hung and Lau, along with Lam, were all involved on an email chain in which instructions were given to prepare these contracts. Hung's explanation that "within mainland China, often parties help each other out" concedes that something was actually being done here, and that it was not merely a proposal The last email in the chain says that the payment terms have been "changed to 40% deposit, balance by COD." These terms correspond precisely to the payment terms in the flow chart between China Square and Xunxiang. Lau's suggestion that this was a "coincidence" is incredible given the precise and detailed nature of the documentation of these arrangements.

[764] The claim that the flow chart was merely a proposal is also inconsistent with the evidence that Sino-Forest employees were also involved in emailing other draft contracts and invoices as between Xunxiang and Bohu, including arranging for their stamping.

[765] The combined effect of these communications and documents clearly demonstrate that the Xunxiang log purchases were not with an arm's length entity and that the transactions were not *bona fide* commercial transactions. Xunxiang's finances were managed (or at least overseen) by senior Sino-Forest officers, including Ip and Hung. The flow of the transactions and funds was structured and managed, beginning to end, almost entirely by Sino-Forest personnel working under Mr. Chan, Ip and Hung.

[766] Essentially no logs were delivered. Xunxiang never returned the deposits. As outlined below, EPHL only recovered about $10 million of a much larger arbitration award, which was only possible because EPHL obtained a *Mareva* injunction freezing some of Xunxiang's assets before they, like the balance of the deposit monies, were moved beyond Sino-Forest's reach.

[767] The Xunxiang transactions were, I find, a fraud designed to divert money from Sino-Forest to entities secretly controlled by Mr. Chan and his associates.

Sino-Forest's Loss and the Xunxiang Arbitration

[768] Sino-Forest lost at least $85.8 million in cash on the Xunxiang transactions (prior to taking into account payment of approximately $10 million received under the RAPA, addressed below).

[769] Prior to the sale of EPGL to New Plantations on April 21, 2016, EPHL sought to recover the Xunxiang deposits and payments. EPHL obtained a freezing order against Xunxiang which attached cash in Xunxiang's bank accounts of approximately $12.5 million. EPHL also instituted arbitration proceedings against Xunxiang.

[770] The arbitration panel found in favour of Sino-Panel and Sino-Wood, the subsidiaries which were parties to the contracts. Sino-Forest was awarded $87 million together with interest and costs. Shortly after this award, EPGL was acquired by New Plantations, which consequently acquired the rights to the award. Following the acquisition, New Plantations settled the collection of the award to the extent of the funds secured by the freezing order, about $12.5 million.

[771] EPHL is entitled to 80% of the recovery from the Xunxiang arbitration under the RAPA. As a result, EPHL received $10 million under the RAPA, which the plaintiff has applied to reduce the total loss suffered by Sino-Forest.

[772] Mr. Chan's damages expert, Ratner, criticized Steger's quantification of this loss on the basis that he ought to have made an estimate of how much of the $87 million could reasonably be recovered. Ratner took the position that the Litigation Trust's damages should be calculated as though EPHL realized on the entire amount owing under the arbitration award.

[773] I am unable to agree with the defendants' argument on this point. EPHL did not receive the entire arbitration award; EPHL only ever recovered its 80% share of the frozen funds actually recovered. Prior to and during the arbitration, Li Hai Bo refused to disclose what happened to the tens of millions of dollars that Xunxiang received from Sino-Forest. If Mr. Chan caused Sino-Forest to pay fraudulent deposits to his nominee, it does not lie in his mouth to say there ought to have been full recovery on the award. New Plantation's acceptance of the seized amount in satisfaction of the entire award reflects the business reality, entirely supported by the evidence in this case, that Xunxiang was not good for the money and that further pursuit of Xunxiang would be throwing good money after bad. Mr. Chan is therefore liable for the full extent of Sino-Forest's resulting loss that remains unrecovered from Xunxiang.

PT Anka

[774] The plaintiff also argues that a further $7.2 million was diverted through transaction with PT Anka concerning, not wood logs, but plywood purchases. On December 7, 2010, Mr. Chan, on behalf of Sino-Wood, entered into a $15 million agreement with PT Anka for the supply of plywood and authorized the payment of an unsecured deposit to PT Anka of $7.5 million. Mr. Chan also authorized Sino-Forest's funding of the deposit.

[775] No plywood was ever delivered to Sino-Forest pursuant to the agreement with PT Anka, nor was the deposit returned.

[776] The plaintiff concedes that he has been unable to establish any connection between Mr. Chan and PT Anka.

[777] Instead, the plaintiff asks for a leap of faith. The plaintiff argues that the payment of unsecured deposits is, of itself, evidence of breach of Mr. Chan's fiduciary duty and negligence.

[778] I am unable to agree. It is not sufficient, to prove wrong-doing, merely to show there was a loss. The lynchpin to the impropriety in the other four cases of deposits lost was the evidence that the transactions were not arm's length. That evidence is lacking here.

[779] The claim with respect to PT Anka is therefore dismissed.

Conclusion

[780] The preponderance of probabilities arising from all the evidence surrounding four of these wood log deposit transactions is that they were a fraudulent mechanism for the diversion of funds out of Sino-Forest into entities controlled by Mr. Chan or others acting at his direction, for the purpose of secretly enriching Mr. Chan and his associates in the fraudulent venture.

[781] I accept Steger's calculation of the wood log deposit fraud loss of $167.4 million. From this must be deducted the net recovery by EPHL of $10 million, for a net loss to Sino-Forest of $157.4 million.

March Maple

[782] Mr. Chan was the director and legal representative of three of Sino-Forest's PRC subsidiaries, Sino Maple Trading, Sino Maple Shanghai, and Jiafeng Suzhou (the "Floor Paneling Subsidiaries"). Mr. Chan testified that March Maple was the primary distributor in the PRC of wood flooring products on behalf of these three subsidiaries.

[783] Mr. Chan testified that in late 2005 or early 2006, Sino-Forest advanced funds to March Maple for the purpose of establishing retail flooring panel outlets in the PRC. Mr. Chan did not dispute Mr. Borrelli's evidence that the amount advanced was RMB 14 million.

[784] March Maple was an undisclosed related party. Mingchen Li, who was a Sino-Forest employee, was also a 60% shareholder of March Maple. Li held various management positions with Sino-Forest's flooring panel subsidiaries from 2002 to 2008.

[785] In his affirmation, Mr. Chan testified that Sino-Forest, through its subsidiaries, purchased 51% of March Maple in 2007 but that the transaction was subsequently reversed. Mr. Chan said he approved the transaction and its subsequent reversal.

[786] It appears that the transaction was reversed because David Horsley, Sino-Forest's Chief Financial Officer, raised significant concerns about the acquisition. In an email to Mr. Chan on December 16, 2007, Horsley said:

> I learned from EY that we purchased Sino-Maple? Who was responsible for the deal? Are we going to have to write-off the 11 million receivable. What is the business case for buying the company. Under the authorization policy, you and I should have seen this deal and both signed off on the deal. This raises concerns on

> EY part and my part. We need to see the financial statements to see if there is an 11 million write-off.

[787] Mr. Chan was confronted with this email during cross-examination. He retreated from his affirmation and testified that he did not actually know what happened: “yeah I don’t know. And also I don’t even know whether it was actually done or reversed.”

[788] On April 13, 2012 and October 8, 2012, two of Sino-Forest’s floor paneling subsidiaries provided cash guarantees in the total amount of about CAD$13 million for two loans obtained by March Maple from a PRC bank. A chop with Mr. Chan’s name appears alongside the Sino-Forest subsidiary chop on each pledge. March Maple defaulted on the loans and the cash pledges were called on, resulting in a loss to Sino-Forest of about CAD$13 million in today’s currency.

[789] In his affirmation, Mr. Chan testified that his personal chop had always been kept in the Sino-Forest PRC branch office. After June 2011, he had no access to his personal chop. He speculated that if there were guarantees using his chop, they were likely done with the approval of new management. In any event, Mr. Chan deposed that he played no role in these guarantees in 2012 and his chop was used without his knowledge or consent. When pressed on this issue in cross-examination, Mr. Chan said that he would need to “make investigation into why a chop with my name is put there.”

[790] Although this transaction is highly suspicious, I am not satisfied the evidence rises to a preponderance of probabilities that Mr. Chan fraudulently caused Sino-Forest to issue guarantees for the March Maple loans. Unlike the transactions analyzed above, there is no evidence linking Mr. Chan personally to March Maple or suggesting Mr. Chan or his friends personally benefited from the loans. There is no evidence about who placed these loans or when or why this was done. There is no evidence about how or why Sino-Forest agreed to pay on the guarantees. Mr. Chan’s chop was used, but after he resigned from office and no longer had access to Sino-Forest’s premises. Apart from the fact that his chop was used, there is simply no evidence linking Mr. Chan to this transaction or to this loan. For these reasons, I am unable to conclude that Mr. Chan is liable for the loss of CDN$13 million in connection with the March Maple loans.

Greenheart

Overview

Plaintiff’s Allegations

[791] The plaintiff contends that an early, and perhaps exploratory, use of secret nominees to conceal self-dealing and fraud by Mr. Chan occurred in connection with Sino-Forest’s ultimate acquisition, between 2007 and 2010, of a company called Greenheart Group Limited (Greenheart) and its subsidiary, Greenheart Resources Holdings Limited (GRHL). The two companies are collectively referred to as the Greenheart Group.

[792] GRHL was a BVI company whose primary business was owning and operating natural forest concessions in Suriname, South America.

[793] Fortune Universe and Montsford were two BVI companies that held approximately 29% of GRHL's total issued share capital in early August 2007.

[794] A number of contemporaneous documents, many found on Yosanda's computer, indicate that Mr. Chan secretly controlled Fortune through the appointment of Lei Guangyu as his nominee director and shareholder and Montsford through the appointment of John Zeng, again as Mr. Chan's nominee.

[795] Mr. Chan was aware by 2007 that GRHL was in serious financial difficulties and considered by at least one investor to be "technically insolvent." In May 2007, Lei (then GRHL's Chairman) advised Mr. Chan and other shareholders that the GRHL business was not viable and ought to be closed down.

[796] Mr. Chan, without disclosing either GRHL's financial and operational problems or his secret interest in the company, nevertheless caused Sino-Forest, through a series of transactions between July 2007 and 2010, to obtain a majority interest in GRHL by acquiring (a) shares in GRHL (including from Fortune and Montsford) and (b) a majority interest in GRHL's majority shareholder Greenheart.

[797] Sino-Forest ultimately invested $202.2 million in Greenheart Group through cash, loans and the issuance of shares, even though the Greenheart Group operated at a loss in each of the years 2007 to 2011.

[798] Following the CCAA Plan, the Sino-Forest Group's interests in GRHL and Greenheart were sold and Sino-Forest suffered a loss of at least $93.2 million through this investment orchestrated by Mr. Chan.

[799] In contrast to the $93.2 million loss suffered by Sino-Forest, Mr. Chan made a secret profit of $37.86 million from the Greenheart transactions through his undisclosed interests in Fortune and Montsford.

Defendant's Position

[800] The defendant denies that he held any interest in Fortune or Montsford or that he earned any secret (or other) profit from that interest. The defendant testified on this issue, and lead additional evidence from others, including Yosanda, Lei and Zeng.

[801] Mr. Chan became aware of Suriname forestry opportunities through Jim Lok, whom he had known since 1994, Lei Guangyu, whom he had known since the 1980s, and Tommy Lui. They were all investors in Greenheart and its predecessor corporation Super View International Limited ("Super View").

[802] In 2004, Lei subscribed for shares representing 22.75% in Super View through his company Shenzhen Hongji for $7 million. Shenzhen Hongji had been a PRC state owned enterprise that Lei bought into when he left a position with the PRC government. A PRC government owned corporation continued to own 20% of Shenzhen Hongji during the period Shenzhen Hongji held shares in GRHL.

[803] Lei produced an agreement by which Shenzhen Hongji acquired the shares and bank records showing he paid for this investment. Lei played an active role in GRHL's affairs as Chairman and in the detailed monitoring of its business and affairs in 2006 and 2007.

[804] Lei had been a friend of Mr. Chan's for over 20 years. Lei testified that around the time Shenzhen Hongji subscribed for Super View shares, he decided to hold the shares in a BVI company. He knew Yosanda had experienced in setting up BVI companies and asked Mr. Chan for Yosanda's assistance. Mr. Chan told him to contact Yosanda directly. He did so, asking Yosanda to take care of all the formalities. Yosanda then proceeded to prepare all of the incorporating documents for Fortune Universe.

[805] Zeng was also an investor in Super View and conducted negotiations to purchase his shares during 2004 and the first half of 2005, eventually committing verbally in 2005 to purchase 175 million shares.

[806] Zeng also asked Yosanda to help set up his BVI company. Zeng is a PRC trained lawyer, qualified in 1993. He co-founded the Kai Tong law firm in 2007. Zeng had known Mr. Chan since 2000 and, by 2004, they were friends. Zeng testified that although he was a trained lawyer working at a PRC law firm in 2005, the firm was not strong in forming overseas companies. Zeng testified that it was "easier" for Yosanda to take care of the formalities and procedures for setting up a BVI company for him.

[807] Because he travelled frequently, he also asked Yosanda to take care of all matters relating to the operation of Montsford, including keeping copies of the corporate documents, the company chop and passing on Zeng's instructions on various matters relating to the company. Any documents, including share certificates relating to Montsford, were kept for him by Yosanda in Hong Kong.

[808] In October 2006, Lei and Zeng attended a social dinner with Mr. Chan. Zeng threw out the idea of selling his interest in Greenheart. Mr. Chan said he would consider buying it. Lei also said he was interested in selling. Lei and Zeng did not pursue the idea and Mr. Chan never raised it with them again either.

[809] After this dinner, Mr. Chan asked Yosanda to prepare share transfer documents in case he decided to purchase Lei and Zeng's interest. Yosanda prepared the documents and sent them to Mr. Chan's lawyer, May Tsui, for comments. She received comments back but the share transfer documents were never used because Mr. Chan never pursued the purchase.

[810] Zeng testified that, although he verbally committed to buying 175 million Super View shares in the first half of 2005, he did not sign the relevant documents making him the sole shareholder and director of Montsford until 2006 or 2007. These documents were backdated to January 2004, the date of incorporation of the company.

[811] According to Yosanda, in March, 2007, Zeng telephoned her asking whether draft documents had been prepared for Zeng to resign as a director and appointing Mr. Chan as a director and transfer of Zeng's shares. Yosanda confirmed to Zeng that the documents had been prepared. After the call she went back to check by opening the draft document on her computer, then clicked 'save and close.' Zeng told her "when it is needed, I will call you." Yosanda never actually sent the documents to Zeng because he never told her he needed them.

[812] By early 2007, a Sino-Forest subsidiary had entered into an agreement with, and started to order logs from, GRHL. Alfred Hung said Sino-Forest's overall strategy was that Sino-Forest would enter into a long-term supply agreement for Suriname logs in conjunction with an equity investment. In the spring of 2007 plans crystallized for GRHL to go public through a reverse takeover ("RTO") of a shell corporation listed on the Hong Kong stock exchange.

[813] GRHL needed to fund the RTO. In order to raise the necessary funds, GRHL made a rights offering to existing shareholders. In May 2007, GRHL forwarded correspondence to Yosanda and Hung concerning shareholders Fortune and Zeng regarding the rights offering of Class B shares which was to close 5 June 2007.

[814] The Class B rights offering was priced attractively to encourage existing shareholders to take up their allotment. Mr. Chan says he indicated to GRHL that if there was a shortfall on subscriptions for the rights, Sino-Forest would take up the remainder. In the end, existing shareholders took up all of the rights on offer.

[815] Lei sent a message to Mr. Chan, wanting to speak to Mr. Chan about the rights offering, Lei had expressed very critical views about GRHL operations and management immediately prior to this. Mr. Chan did not respond to Lei's message. Mr. Chan said he was certain Lei was calling about Sino-Forest's intentions about doing a deal with GRHL. Since Sino-Forest had firm plans by that time about how it was going to participate in GRHL, Mr. Chan felt it was untenable for him to speak to Lei about those plans.

[816] Lei decided not to take up the rights offering available to Fortune. He testified that he never discussed the matter with Zeng and only later found out that Zeng had taken up the rights offering, including the shares allotted to Fortune.

[817] Zeng took up the GRHL rights offering and bought all the shares allotted to Montsford. He also had Montsford buy the allotments of other shareholders, such as Fortune, who decided not to take up the rights offering. Montsford ultimately held about 1.6 billion shares in GRHL.

[818] Under the July 2007 Master Sales and Purchase Agreement between GRHL and Sino Capital Global Inc., GRHL was committed to sell a stated quantity of Suriname logs over a stated

period at a fixed price. The 2007 agreement also granted an option to acquire one billion shares of GRHL at a price of $0.006. Sino-Capital immediately exercised the option, paying $6 million. The second part of the transaction was completed a month later when the takeover was completed. A shell company, Omni Corp Limited ("Omni Corp"), purchased 60% of GRHL, for a total value of $80 million. This compared very favourably to the $6 million price Sino-Forest paid for 1 billion Class B shares which translated into a total capitalization for GRHL of under $46 million.

[819] In the August 2007 Omni Corp transaction, Sino-Forest sold 60% of its GRHL shares. Sino-Forest received cash and securities worth $6,298,077, thus receiving all of its initial investment back while still retaining 40% of its interest in GRHL.

[820] There is no evidence that Sino-Forest or its subsidiaries received deficient performance from GRHL in respect of its purchase of Suriname logs under the Master Sales and Purchase Agreement. Further, the investment by Sino-Capital of $6 million to acquire 1 billion shares of GRHL immediately prior to the Omni Corp reverse takeover transaction proved to be a very provident transaction for Sino-Capital because it recovered substantially more from its investment than the cost while still retaining 40% of its interest.

[821] Lei testified that he sold the Greenheart shares held by Fortune between 2007 and 2010 for cash, shares and convertible bonds. This included Sino-Forest shares, which he later also sold. The proceeds went into Lei's Hong Kong bank account.

[822] Zeng also sold his GRHL shares at about the same time but had no Hong Kong bank account. Zeng deposited Montsford's sale proceeds into Lei's bank account. The money deposited by Montsford was subsequently dealt with in accordance with Zeng's instructions.

[823] Lei testified that he owed money to Zeng and that Zeng was indebted to Mr. Chan. Lei said that, at Zeng's request, he remitted funds received by Fortune Universe and Montsford to a third party in order to repay: a) Lei's debt to Zeng; and b) Zeng's debt to Mr. Chan.

[824] Zeng also testified that he owed money to Mr. Chan, which he said was unrelated in any way to his purchase of Super View or GRHL shares. When Montsford earned cash from its GRHL investment, Zeng used that money to repay a portion of the loan he owed to Mr. Chan.

[825] In 2011, Lei decided to sell the Sino-Forest shares he held through Fortune. He contacted Mr. Chan to ask whether it was a good time to sell. Mr. Chan, however, did not want to discuss it with him. Mr. Chan advised Lei to ask Yosanda for details on how to sell the stock. Lei called Yosanda to request her help.

[826] On Yosanda's advice, Lei opened a securities trading account with a broker in Hong Kong. Yosanda liaised with Lei's secretary to establish the account. Yosanda advised Lei not to sell all his shares in one go as this might suppress the price. He therefore sold the shares in a number of transactions.

Overview of Conclusion

[827] In my view, the preponderance of the probabilities of the case, having regard to the evidence as a whole, is that:

(a) Lei and Zeng were Mr. Chan's nominees. Mr. Chan was the beneficial owner of Fortune and Montsford;

(b) Mr. Chan caused Sino-Forest to invest in the Greenheart Group while concealing his interest in Fortune and Montsford from Sino Forest and the Board;

(c) Mr. Chan had inside information about the dire financial situation Greenheart Group was in but did not disclose that information to Sino-Forest and the Board;

(d) Mr. Chan made a secret profit from his investment in the Greenheart Group through Montsford and Fortune of $39.65 million; and

(e) Sino-Forest, although its investment initially appeared provident, ultimately suffered a loss of $93.2 million on its Greenheart Group acquisition.

My reasons for reaching these conclusions are set out below.

The Formation of Fortune and Montsford

[828] Mr. Chan does not deny that his assistant, Yosanda, helped set up and administer both Fortune and Montsford throughout their corporate existence. Mr. Chan denies that this indicates he had an interest in these companies. Rather, Mr. Chan says that his secretary was only assisting his friends, Lei and Zeng.

Montsford

[829] While Montsford appears to have been involved with GRHL as far back as December 2005, the contemporaneous documentary record gives no indication that Zeng was involved with Montsford at that time.

[830] Xu Ni, Sino-Forest's legal officer, attended a meeting on December 13, 2005 regarding the Suriname project. In a December 22, 2005 email, she forwarded minutes of that meeting to the other attendees and to Yosanda "for Allen's reference." The email and minutes make no reference to, and were not sent to, Zeng.

[831] The minutes do make reference to actions to be taken by Montsford in connection with the Suriname project and, in particular, the reorganization of Super View into Greenheart and Montsford's participation in the "operational" aspects. Montsford appears on the signature page of the minutes as "present" without reference to Zeng, whereas Lei, Lok and 'Thomas Kok' are named in person and, of course, Xu Ni was herself present. The fact that Mr. Chan received the

minutes while Zeng did not, even though Montsford's involvement was expressly contemplated, is inconsistent with Zeng's involvement in 2005.

[832] Mr. Chan's evidence in chief was that:

> At some point in 2005, Lei and Zeng each separately contacted me to ask for help in setting up a BVI company for the holdings of the Suriname company… After Zeng picked the company name Montsford from the list of companies provided by Yosanda, Yosanda told me about this. I told her to tell Tommy. He was in charge of the Suriname business.

[833] In cross examination, however, when confronted with Xu Ni's email and minutes, Mr. Chan said he could not "remember at which point in time that John Zeng became the owner of Montsford."

[834] Mr. Chan could not explain why Zeng was not named in the minutes or copied on Xu Ni's email even though this was supposed to have been three months after Zeng chose the name Montsford and agreed to invest.

[835] There are no contemporaneous documents that reflect Zeng exercising any substantive role as director and shareholder of Montsford. Zeng attached no documents to his affirmation to support his claim that he was an investor in GRHL. Zeng was never copied on any email correspondence to shareholders regarding GRHL's business and operations.

[836] Mr. Chan, on the other hand, was copied on a significant volume of correspondence long before Sino-Forest ever had an interest in GRHL.

[837] During his evidence at trial, Zeng refused to disclose from whom he purchased his shares in Super View, relying on an alleged "confidentiality" provision in an agreement "signed" between him and the seller. This agreement was not produced. Zeng was impeached on this answer, which was inconsistent with an answer given under oath to the same question when cross-examined in prior interlocutory proceedings. At that time, Zeng had relied upon a purported "privilege" claim in order to avoid disclosing the identity of the seller.

[838] Zeng was then asked when he paid for the Super View shares. Having previously referred to a written agreement, he further amended his version of events and said there was a verbal agreement reached towards the end of 2005. All he could say was that he paid for the Super View shares between 2005 and the "first half of 2007" and that he could not recall how much he paid for them.

[839] Although Zeng asserted Montsford was his company, he flatly refused to say how much he paid, when he bought it or who he bought it from. Zeng steadfastly refused to agree to even the most obvious, simple questions about his acquisition of Montsford and GRHL shares. Zeng was difficult and evasive. His interpretation of documents was frequently at odds with the plain

language used. His evidence was contrived and inconsistent with both contemporaneous documents and the evidence of other witnesses. I found Zeng to be a most unreliable witness.

Fortune and Spirit Land

[840] Lei testified that Fortune was always his company. Lei's company, Shenzhen Hongji, paid US$7 million for Fortune's shares of Super View. Lei asked Mr. Chan if Yosanda could assist in setting up Fortune, since Yosanda was experienced in setting up BVI companies.

[841] I found Lei's explanation implausible given that:

(a) Lei is an experienced business man with his own secretary, Nancy;

(b) Lei and his wife co-owned Spirit Land, a BVI company which also held shares in GRHL. Lei was asked at trial who handled the incorporation and administration of this company. Lei's response was that: "My wife found her people to do the work. I had not asked her about that." Lei and his wife were therefore able to incorporate Spirit Land without help from Yosanda.

(c) Lei also gave evidence that he had another BVI company, Recent Fortune. Yosanda confirmed under cross-examination that she had not assisted Lei in incorporating Recent Fortune. Lei was able to set up and run Recent Fortune without Yosanda's assistance.

[842] Unlike Zeng, Lei was willing to disclose how Fortune acquired its shares in GRHL. According to Lei, Fortune's GRHL shareholding originated from the purchase of Super View shares by his company, Shenzhen Hongji. Mr. Chan and Lei relied upon this as proof that Fortune was really Lei's company. However, in cross-examination Lei was eventually forced to admit in the face of documentary evidence that he held funds belonging to Mr. Chan in Shenzhen Hongji and, he said, invested Mr. Chan's money in various securities from time to time on a purely discretionary basis.

Lei and Zeng Become Nominee Directors and Shareholders

[843] Lei and Zeng took no independent steps to have their directorship and ownership of Fortune and Montsford formalized despite the passage of at least twelve months from when they selected their companies in September 2005. Similarly, Yosanda, whose assistance they had sought, took no steps to install them as directors until late 2006 for Fortune and March 2007 for Montsford.

[844] Lei's and Zeng's disinterest in formalizing their appointments to Fortune and Montsford is consistent with their acting as Mr. Chan's nominees since the formalization process only occurred at the same time that Yosanda set up a nominee shareholding structure to ensure that Mr. Chan controlled both entities.

[845] Draft resolutions were found on Yosanda's computer recording the resignation of Lei and Zeng as directors of Fortune and Montsford respectively, and appointing Mr. Chan as replacement director of each company, together with share transfer documents transferring the shares in both companies to Mr. Chan for a consideration of HKD$1.

[846] Mr. Chan denies that these documents made Lei and Zeng his nominees. Instead Mr. Chan claims that these documents resulted from the social dinner with Lei and Zeng during the fall of 2006 in which the three discussed a possible sale of Fortune and Montsford. At this dinner, Lei and Zeng both discussed selling their shares in GRHL to Mr. Chan. Mr. Chan asked Yosanda to prepare documents "just in case." However, according to Mr. Chan, Zeng and Lei, this proposed transaction did not proceed. Both Zeng and Lei testified that they did not pursue the matter further after the dinner party. The contemporaneous documentary evidence, however, indicates that the evidence of Mr. Chan, Lei and Zeng on this point is not correct.

[847] It is uncontroverted that neither Lei nor Zeng had been appointed as the director of Fortune or Montsford at the time of the purported social dinner in October 2006. Nor had either been formally recorded as the shareholder. Lei was appointed the first director and shareholder of Fortune later in October 2006. Zeng was not appointed first director and shareholder of Montsford until March 2007.

[848] The evidence supports the conclusion that the preparation of these first appointment documents coincided with the timing of the preparation of the share transfer documents in each case. The Fortune nominee documents were prepared in October 2006 and the Montsford nominee documents were prepared in March 2007.

[849] During her cross-examination, Yosanda attempted to explain the last modified date of March 16, 2007 on the Montsford nominee documents by claiming that Zeng called her on March 16, 2007 to follow up on the share transfer documents. This caused her, she said, to check on the documents and then press save and close. This testimony is in conflict with Zeng's evidence that he never followed up on the casual dinner discussion with Mr. Chan and Lei after the fall of 2006.

[850] Another document found on Yosanda's computer is an executed instrument of transfer from another BVI company, called Max Move Developments, to Montsford dated March 8, 2007. It indicates that Montsford paid HKD$1 for its 175 million shares in GRHL on March 8, 2007. This document also supports the conclusion that Montsford's nominee documents were not prepared until March 2007, some five months after identical documents were prepared for Fortune. It suggests that Zeng did not need to execute nominee documents for Montsford until Montsford actually acquired its shareholding interest in GRHL. That did not take place until March 2007.

[851] Another reason to reject the evidence of Mr. Chan, Zeng and Yosanda on this point is that, although Lei testified in chief that both he and Zeng offered to sell Mr. Chan their shares in GRHL at the October 2006 dinner, Lei changed his evidence during re-examination. In re-examination, Lei repeatedly stated that it was not until after he resigned as Chairman of GRHL,

which occurred in May 2007, that he became aware that Zeng had invested in GRHL. If Lei did not know that Zeng invested in GRHL until May 2007, it is not possible that he attended a dinner in October 2006 at which both he and Zeng offered to sell Mr. Chan their interests in GRHL.

[852] Further evidence that the Greenheart share transfer documents were nominee documents as opposed to simply documents for a possible future transaction can be found in a letter to Zeng found on Yosanda's computer. The letter was created on March 16, 2007, the same day that the Montsford nominee documents were prepared. The letter says in part:

> Lawyer Zeng,
>
> The attachment is a pre-signed document, the content of which is that you resign as a director and appoint Allen as a director; also, please transfer shares to Allen. Thank you!
>
> (Remarks: It will not be dated for now, and it will be dated in the future when necessary.)

[853] The fact that Yosanda prepared a letter to Zeng requesting that he sign the Montsford nominee documents but leave them undated (until needed) makes it clear that Yosanda was setting up a nominee structure for Montsford on Mr. Chan's behalf.

[854] While the plaintiff only found unexecuted Word versions of the Fortune and Montsford nominee documents on Yosanda's computer, there is evidence that they were in fact signed.

[855] Yosanda kept an index listing the contents of a safe inside Mr. Chan's office. This index was found on her computer. The index has an entry for "Fortune Universe & Montsford's BVI documents for change of directors and shareholder." Yosanda initially admitted during her cross examination that this was a reference to *executed* share transfer documents.

> MR. BELL: Okay. And Mr. Lei and Mr. Zeng, they ultimately signed these share transfer documents, as you call them, didn't they?
>
> A. They did sign.
>
> Q. And you ultimately kept those signed transfer documents in the company safe that was kept in Allen Mr. Chan's office, didn't you?
>
> A. Correct.

[856] Later, however, Yosanda resiled from this admission. When confronted again with this entry in her index to the contents of Mr. Chan's safe, Yosanda claimed that she put draft, unsigned versions of the documents in the safe "for easy retrieval" and because "I was afraid that I may lose them."

[857] I am unable to give any credence to this latter evidence. It simply makes no sense. There is no reason to put unsigned, draft Word documents in a locked safe; Word documents are routinely, and easily, found on and retrieved from the computer on which they were prepared and stored. That is, in many ways, the point of a computer.

[858] I find that Yosanda's evidence was contrived. She initially made an entirely logical admission that the documents stored in Mr. Chan's locked safe were signed, not merely drafts. Later, realizing she had mistakenly gone off script by telling the truth, she resiled from that evidence and made up an implausible alternative. I found Yosanda to be a very unreliable witness. She was evasive and argumentative. She repeatedly placed farfetched or implausible interpretations on contemporaneous documents which were completely at odds with her own recorded communications at the time. Where her testimony differs from contemporaneous documents, I prefer the contemporaneous documents and reject her after the fact interpretations.

Yosanda Administered Fortune and Montsford's Affairs

[859] There is no dispute that Yosanda dealt with most (if not all) administrative matters pertaining to Fortune and Montsford from 2005 to 2011.

[860] One aspect of Yosanda's management was the direction of payment of proceeds received by Fortune and Montsford on account of their shareholdings in GRHL. The evidence clearly establishes that these directed payments included $256,000 to Mr. Chan's alma mater and $328,000 to Mr. Chan's companion.

[861] Mr. Chan, Lei and Zeng explain these payments as follows:

(a) Zeng did not have a Hong Kong bank account so he asked Lei if proceeds payable to Montsford could be paid into Lei's account. Lei agreed;

(b) Zeng had previously borrowed money from Mr. Chan;

(c) Zeng used the proceeds received from Montsford and paid into Lei's account to settle his loan to Mr. Chan by way of directed payments;

(d) Lei also allowed Zeng to use the proceeds received from Fortune (Lei's company) to settle Zeng's loan to Mr. Chan on the basis that he and Lei kept a running loan account.

[862] There is no documentary evidence of any loan (other than an IOU) or accounting to support the existence of Mr. Chan's loan to Zeng or Zeng's running account with Lei.

[863] During cross-examination, neither Zeng nor Lei were able to explain why such a circuitous route was adopted to distribute funds that were ultimately paid for Mr. Chan's benefit or why Zeng did not simply instruct that payments to Montsford be paid to Mr. Chan directly to satisfy

Zeng's purported debt. The strong inference to be drawn in the circumstances is that the circuitous flow of funds was meant to conceal the fact that Mr. Chan was the ultimate recipient.

[864] The assertion by Lei and Zeng that it was Zeng directing this flow of funds also does not accord with contemporaneous emails. Yosanda's direction to Nancy (Lei's assistant) on December 12, 2007 (this was copied to Hung) informed Nancy that monies were coming into Lei's account and that Yosanda would give instructions later on what to do with the money.

[865] In another email exchange between Lei's secretary and Yosanda on March 4, 2009, dealing with further share proceeds, Nancy attached three deposit slips for payments deposited into Lei's bank account, stating "total 3 pages but only two are for yours." It is clear in the context that "two are for yours" is a reference to Fortune and Montsford. The third deposit slip for a smaller amount related to proceeds due to Spirit Land, the company owned by Lei and his wife.

[866] Mr. Chan could provide no explanation when confronted with this email on cross-examination. Yosanda speculated that Nancy must have assumed that interest payments made to Fortune and Montsford would be dealt with in the same manner as a previous transaction in which payments had been directed to Mr. Chan's companion.

[867] I simply do not accept Lei, Zeng or Yosanda's evidence. The documents make it clear what was going on. Yosanda, on Mr. Chan's behalf, was calling the shots. This is because it was known to all that this was beneficially Mr. Chan's money. The undocumented loans, the circuitous flow of funds, the nonsensical speculations about what Lei's secretary, who did not testify, may or may not have been thinking – these things are fabrications to conceal the central fact that emerges out of all these arrangements: Montsford and Fortune were Mr. Chan's companies and the proceeds of sale of their assets (GRHL and Sino-Forest shares) were Mr. Chan's funds.

2007: GRHL in Financial Distress

[868] There are many contemporaneous documents indicating that Mr. Chan had extensive involvement in GRHL's affairs long before the Sino-Forest invested in the company. In his affirmation, Mr. Chan tried to explain away this involvement by claiming that he was monitoring "the Suriname project from a distance" with a view to possibly having Sino-Forest invest at some stage. However, this explanation cannot be reconciled with the large number of emails and minutes of meetings sent to Mr. Chan about this project. These documents reveal Mr. Chan's deep involvement in the affairs of GRHL over a number of years before Sino-Forest became involved. The depth of his involvement is consistent with a personal and financial interest.

[869] This is relevant for two reasons: (a) it constitutes additional circumstantial evidence that Mr. Chan had an undisclosed financial interest in GRHL at the time he caused Sino-Forest to invest; and (b) it shows that Mr. Chan was fully aware of the extreme financial difficulties GRHL

was facing at the time he caused Sino-Forest to invest funds in order to bail out the floundering company.

[870] Prior to receiving Sino-Forest's investment in July 2007, Mr. Chan was aware GRHL was in serious financial difficulty. In a lengthy email to Mr. Chan on March 9, 2007, one investor, David Van Oppen, reported to Mr. Chan:

> Allen, I think the situation needs some serious attention. Six months ago Tommy told us that the company could comfortably run on its own cash flow even without an IPO. Today it is technically insolvent…Can we sit down and discuss?

[871] Tommy Lui, another shareholder of GRHL, sent emails to Mr. Chan in which Lui argued that Mr. Chan owed a duty to GRHL to help resolve its financial difficulties. Liu said that if Mr. Chan did not make himself available for a key monthly meeting in April 2007, "it will be unfair for the other parties to shoulder all the responsibilities and not getting appreciated for their efforts." Mr. Chan speculated during cross-examination that Lui was simply urging him to have Sino-Forest invest in GRHL "for the pending IPO that they are planning."

[872] In another email from Lui to Mr. Chan dated April 26, 2007 with the heading "We need to meet and communicate," Lui expressed his disappointment with Mr. Chan and stated that GRHL's business "cannot continue without a clear direction and firm commitment from the shareholders." When cross-examined on this email, Mr. Chan denied that the email was a communication from one GRHL shareholder to another. Again, Mr. Chan contended that Lui was trying to pressure him into having Sino-Forest invest in GRHL.

[873] Mr. Chan replied to Lui's email of April 26, 2007 by referring to his "long & substantial supports for the subject venture" which had left him "nothing on [his] conscience for they are material, fundamental and significant." Mr. Chan went on to say that everyone had agreed to move forward "regardless percentage of success."

[874] In a report dated May 6, 2007, which was presented at a meeting between Mr. Chan, Lok, Lui and Lei on May 9, 2007, Lei provided his detailed observations on GRHL's operations following an onsite inspection. Lei, who was GRHL's Chairman at the time, concluded that the chances of successfully carrying out large scale tree harvesting or wood processing in Suriname were "very small."

[875] During cross examination, Lei tried to distance himself from the views expressed in his report by reference to extraneous, undocumented events. For example, Lei's report points out that the cost to GRHL of harvesting logs in Suriname was $85 per cubic metre, when the market value of the logs was only $65 per cubic metre. Lei sought to qualify this negative fact at trial by reference to a proposal to buy three barges, which would have reduced harvesting costs. There is no mention, however, of barges or any other cost reduction measures in his report. Nor did any independent evidence support this assertion.

[876] In May 2007, Liu sent Lei and Mr. Chan an email confirming Lei's recommendation to "close down the business." Liu goes on the describe, in Lei's "own words," that "next week's plan was for Allen to consider if Allen did not mind losing money even after having heard your report."

[877] A little more than two months after Lei presented his report to Mr. Chan and recommended closing down the business, Mr. Chan caused the Sino-Forest to invest $6 million in the company.

[878] Mr. Chan also caused a Sino-Forest subsidiary to enter into a July 20, 2007 Master Sale and Purchase Agreement with GRHL. Under the 2007 agreement, Sino-Forest's subsidiary agreed to purchase 34,285 cubic metres of Suriname logs at a price of $175 per cubic metre. This is nearly three times the market price contained in Lei's report, prepared only two months earlier.

[879] Sino-Forest's subsidiary also agreed to pay a $3 million unsecured deposit (representing 50% of the total purchase price) upon signing the 2007 agreement "in order to lock up the supply of the Surname Logs during the contractual period."

[880] Both Mr. Chan and Lei tried to explain away the pricing discrepancy by highlighting the purported quality of logs covered in the 2007 supply agreement. Schedule 1 of the agreement provides that logs from thirty species of trees qualify as Suriname logs for the purpose of the agreement.

[881] Lei's report proceeded on the basis that while there were 60-70 species of timber in GRHL's plantations, only about 30-40 had "commercial value" and "only 10-20 species are commonly seen in the market and more suitable for selling" at a market price of about $65 per cubic metre. This assessment, based on the more exclusive quality of 10-20 species, is completely at odds with the price of $175 per cubic metre stipulated in the 2007 agreement for 30 species. Sino-Forest, therefore, paid a three million dollar unsecured deposit to lock down the exclusive "right" to pay three times the going market rate for logs in Suriname. This incongruity was never explained.

The 2007 Rights Issue

[882] There is no dispute between the parties that:

(a) in late May 2007, GRHL offered its existing shareholders 4.2 billion new class B shares at $0.001 per class B Share on the basis of two class B Shares for every one ordinary share held (the "Rights Issue");

(b) Fortune was allocated 910 million Class B shares for a purchase consideration of $910,000;

(c) Fortune did not take up these shares;

(d) Montsford participated in the Rights Issue and, while it was only initially allocated 350 million Class B shares, it ultimately took up 1,597,830,000 shares.

(e) Montsford's take up of Class B shares moved it from having a relatively modest shareholding of GRHL to becoming the single largest shareholder of GRHL, as at August 20, 2007, holding 23.22% of GRHL's shares.

[883] In an email dated June 6, 2007, Lei's secretary Nancy emailed Yosanda seeking Mr. Chan's instruction on what to do about the rights offering. It says:

> The attached documents concern Greenheart and additional shares. Please send to Allen. Lei says concerning Fortune Universe Limited whether to participate in the issuance of stock, you need Allen's decision. Please convey thank you!

[884] Mr. Chan and Lei gave conflicting evidence on the purpose of this email:

(a) during his examination for discovery, Mr. Chan stated that he had no recollection of receiving the email;

(b) in his affirmation for trial, Mr. Chan deposed that he was aware of "Lei's message" of June 6, 2007 but did not respond because he "was certain that [Lei] wanted to speak about Sino-Forest's intentions respecting doing a deal with GRHL but since Sino-Forest had firm plans by that time about how it was going to participate, it was untenable for [Mr. Chan] to speak to Lei;"

(c) Mr. Chan then again contradicted himself during cross-examination, stating that he believed that Lei had not wanted to take up the Class B shares and was asking whether Sino-Forest would be interested in taking them from him. This made three mutually exclusive explanations from Mr. Chan that were each given under oath. None of these explanations acknowledged the clear wording of the email; i.e., that the decision was Mr. Chan's, not Lei's, to make;

(d) Lei was taken in his evidence-in-chief to the email. He testified that after receiving the rights offer notice, he believed GRHL was not doing very well and he was not familiar with the issuance of new shares. He asked his secretary to write to Yosanda to ask for Mr. Chan's views and comments because Mr. Chan was familiar with the issuance of new shares in Hong Kong. This is yet another explanation for the email and is, like the others, wholly inconsistent with the plain words used at the time.

[885] Mr. Chan's evidence is clear that:

(a) as of the date of the rights issue, Sino-Forest was not entitled to participate as it was not a shareholder in GRHL;

(b) Mr. Chan had indicated to Lui that if there was any shortfall (i.e. shareholders not taking up the full subscription) he should speak to Mr. Chan about Sino-Forest possibly taking up the shortfall; and

(c) Sino-Forest ultimately did not participate in the rights issue as “existing shareholders were eager and all rights were taken up.”

[886] Mr. Chan’s evidence that Sino-Forest did not participate in the rights issue is confirmed by GRHL’s share register. Sino Capital was the only Sino-Forest company to acquire GRHL shares and it did so pursuant to an option exercised under the 2007 supply agreement, not the rights offering. Sino Capital paid $6 million for 1 billion GRHL shares (i.e. six times the price per share offered under the Rights Issue) by way of cheque dated July 23, 2007.

[887] Montsford, in addition to its 350 million Class B share allotment, took up approximately 1.25 billion unallocated Class B shares for a total number of almost 1.6 billion Class B shares.

[888] Arithmetically, a large part of Montsford’s excess Class B Shares must have comprised Fortune’s right to 910 million shares. When asked on cross-examination whether he knew Montsford had taken up Fortune’s allocation, Mr. Chan claimed that he did not have a clear recollection.

[889] Zeng’s evidence concerning how Montsford acquired its Class B shares pursuant to the rights offerings was vague and inconsistent:

(a) he would not agree on how much he spent in acquiring these Class B shares despite clear evidence that the shares must have cost $1.6 million;

(b) he could not recall whether he discussed the rights offering with other GRHL shareholders, only that he did not discuss it with Lei;

(c) he did not know whether the majority of the Class B shares he purchased had been originally allocated to Fortune as he had worked through a “middle man” whose identity he refused to disclose other than to say it was not Mr. Chan; and

(d) he could not recall where he got the money or how he paid $1.6 million for the Class B shares, given his previous evidence that he did not have a Hong Kong bank account. Instead, he refused to accept that he had in fact paid $1.6 million while simultaneously speculating about other possible means by which he could have purchased the shares.

[890] Contrary to Mr. Chan’s evidence that Sino-Forest did not participate in the rights issue, Hung and Yosanda both testified at trial that they thought Sino-Forest did participate and that Hung authorized a payment for these shares on that basis. Yosanda stated that Mr. Chan was the source of her understanding that Sino-Forest in fact took up shares in the rights issue.

[891] Yosanda also gave evidence that she had no recollection of doing anything for Zeng or Montsford with respect to taking up shares under the rights issue.

[892] Hung was cross-examined on an email chain between Yosanda and Daphne Tse (at GRHL) spanning the period June 25, 2007 through to July 19, 2007 titled "Remittance of US$858,000". This chain discussed a "shortfall" payment to be made under the rights issue, its method of calculation and when payment could be expected.

[893] Hung agreed that this email chain related to payments to be made under the rights issue. He recalled the discussion he had with Yosanda regarding payment and confirmed his evidence-in-chief that "This should be an investment made by Sino-Forest. I think I have given instructions to my colleague. My colleague would then carry out the remittance of the funds according to the approval or authorization documents."

[894] At trial, Yosanda was taken to a similar email chain culminating in an email from Yosanda to Hung dated July 16, 2007 in which Yosanda stated "Alfred, there will be an additional shortfall of 52,000. I spoke to Allen and he agrees on this the total # of shares for Allen will be 910,000." Yosanda did not recall the email but reiterated her understanding that the payment related to Sino-Forest taking up shares in the rights issue.

[895] In contrast, Mr. Chan's evidence on this email chain was that Sino-Forest never took up any shares under the Rights Issue. Mr. Chan said:

(a) GRHL was "trying to get Sino-Forest to take up the shortfall";

(b) he did not to know whether "910,000" meant "shares or money" although it is clear from the email that it could not have been shares;

(c) he considered the email chain confusing due to the reference to Lei, Lok and Van Oppen;

(d) the reference to shares "for Allan" was "about whether Sino-Forest will take up the shortfalls of any rights issue;" and

(e) he questioned whether Hung in fact ever made the payment.

[896] On July 19, 2007, in an email exchange between Yosanda and Daphne Tse, Yosanda advised that "Alfred told me that he gave instruction for remittance yesterday. It should be arrive your bank today." Daphne responded that "Our bank just confirmed that the following amount [US$ 858,000] has been received." Mr. Chan was unable to explain why Hung was processing payment for shares that were, on the evidence, ultimately acquired by Montsford.

[897] The most probable inference to be drawn is that these shares were acquired beneficially for Mr. Chan and that Mr. Chan (and Hung) were arranging payment for Fortune's Class B share allotment ultimately taken up by Montsford.

Sale of Montsford and Fortune's Sino-Forest Shares

[898] When Sino-Forest acquired Greenheart, both Fortune and Montsford received Sino-Forest shares as partial payment for their GRHL shares. It is not in dispute that Yosanda was involved in the sale of Fortune's Sino-Forest shares over the period from late November 2010 to February 2011 and Montsford's Sino-Forest shares over the period from December 2010 and into early January 2011.

[899] The plain reading of an email dated November 24, 2010 from Yosanda to Lei's secretary demonstrates that Fortune's Sino-Forest shares were not beneficially owned by Lei:

> President Lei is a director and a shareholder of Fortune Universe. Fortune Universe now holds 144,019 shares of Sino-Forest. We want to sell those shares, so we want to invite president Lei to come to Hong Kong to open a stock trading account for Foutune [sic] Universe, otherwise the shares cannot be sold.

[900] Yosanda, in an attempt to explain away the email, stated in her affirmation that when she typed "we" she intended to refer to "Lei". I do not accept Yosanda's explanation because:

(a) Yosanda conceded at trial that she would never refer to Lei without a title such as "President Lei";

(b) if "we" was replaced with "President Lei" the email would make no sense. Yosanda would be telling Lei's secretary something that Lei would surely have told his own secretary himself; and

(c) the only reading of the email that makes any sense is that Yosanda, on Mr. Chan's behalf, is directing that the shares be sold because they were not Lei's, but Mr. Chan's.

[901] Further support for this conclusion is found in an email chain between Yosanda and Nancy, which commenced with an email dated February 16, 2011. Yosanda confirmed that "Lei sent a text message telling Allen that the stock is in the account and can be sold, the total [no. of] stock is 144,019…"

[902] Subsequent emails in the chain make it abundantly clear that Yosanda was following up on the sale in order to ascertain how much Lei had obtained. Yosanda thereafter told Nancy where to deposit the proceeds, namely into an account of Eminens, Mr. Chan's sister's business.

[903] Yosanda also advised Nancy that for the "sake of book keeping" Eminens would prepare a contract for Lei to sign. The content of these emails are completely inconsistent with Yosanda's explanation that she was simply "helping" Lei. These emails made it clear Yosanda was looking after Mr. Chan's beneficial interest in the proceeds of sale of Fortune's investment.

[904] Lei testified that he wanted to know whether it was a good time to sell Sino-Forest stock, so he called Mr. Chan. Mr. Chan said he could not comment but to ask Yosanda. Then, after Yosanda helped sell the shares, Lei asked Mr. Chan for help avoiding foreign exchange controls in China. Mr. Chan told him to leave the money with his sister, Pauline, at her company, Eminens.

[905] I do not accept the explanations of Mr. Chan, Yosanda and Lei about the disposition of Fortune's Sino-Forest's shares. Their evidence is inconsistent with the plain words of the contemporaneous written communications. It is contrived and implausible. It answers none of these vexing questions: If Mr. Chan felt uncomfortable discussing the disposition of Sino-Forest stock, how is it any less inappropriate for his executive assistant to do it? Why would Lei, an experienced business man and currency trader, suddenly need Mr. Chan's assistant to explain how to dispose of publicly traded stock. Why of all possible investment advisors in Hong Kong, did Mr. Chan recommend, and Lei choose, the business of Mr. Chan's sister, which was not an investment advisor or currency trader?

[906] I find, on a balance of probabilities, that Mr. Chan, through Yosanda, was directing the sale of Fortune's Sino-Forest shares. This was, I also find, because Lei was only a nominee – Mr. Chan was the beneficial owner of Fortune and controlled its assets.

[907] There is less documented evidence concerning the sale of Montsford's shares and the ultimate fate of those proceeds. However, the sale of Montsford's Sino-Forest shares took place in exactly the same time frame as the sale of Fortune's Sino-Forest shares. If Zeng and Lei were acting independently, as they claim, it seems highly unlikely that each of them, two or three years after acquiring the Sino-Forest shares, would, within a few weeks of each other, decide to sell them. In all of the circumstances, I find, on a balance of probabilities, that Mr. Chan, through Yosanda, also directed the sale of Montsford's Sino-Forest shares.

[908] The proceeds of this sale were transferred to Zeng's HSBC account and thereafter transferred to a China merchant bank account in the name of Momentom, with some of the proceeds transferred to Eminens. Momentom appears on the Nominee Company Manager List with "John" listed as its manager. It is not in dispute (Ratner, Mr. Chan's damages expert has acknowledged) that Momentom paid Mr. Chan $2.223 million dollars in 2011 and 2012. This is further evidence from which it can logically and reasonably be inferred that Mr. Chan was the beneficial owner of Montsford and that he received monies ultimately derived from Montsford's sale of GRHL-related securities.

[909] All this evidence supports the conclusion that the profits earned by Fortune and Montsford of $37.86 million were secretly Mr. Chan's profits. These profits were earned by Mr. Chan through deceit and in breach of his fiduciary duty to Sino-Forest. The evidence also supports the conclusion that Sino-Forest paid out a total of $202.247 million to acquire the Greenheart Group. This interest was sold to New Forest, an arm's length purchaser, in 2014 for a total of $109.034 million.

[910] Thus, Sino-Forest suffered a further $93.28 million loss on its investment in Greenheart. This loss was the direct result of Mr. Chan’s deceit and breach of fiduciary duty. The issue of quantification will be addressed below in the “Damages” section of these Reasons.

Application of the Facts to the Law

Fraud

[911] As noted earlier, the tort of civil fraud has four elements:

(i) the defendant made a false representation;

(ii) the defendant had some level of knowledge of the falsehood of the representation;

(iii) the false representation caused the plaintiff to act; and

(iv) the plaintiff’s actions resulted in a loss.

I will review each of these elements below.

(i) False Representations

[912] False representations include misrepresentations by omission, silence, half-truths, inaction, or the non-disclosure of material information.

[913] Mr. Chan made false representations to Sino-Forest. He caused Sino-Forest to record billions of dollars in fictitious assets and hid assets and ownership interests through companies which he controlled by nominees. He concealed the use of non-arm’s-length entities, which he controlled, to conduct business with Sino-Forest. He used a deceitful documentation process to conceal this fraud from the company. Information that was disclosed to Sino-Forest constituted half-truths which added to the deception.

[914] Corporate directors, as fiduciaries, must disclose material information to the corporation and their failure to do so is a misrepresentation. Canadian courts have repeatedly held corporate directors liable for fraud on the basis of knowing-disclosure. Among other things, Mr. Chan purposely and with intent to deceive failed to disclose non-arm’s-length transactions and caused Sino-Forest to invest hundreds of millions of dollars without disclosing these conflicts.

(ii) Mr. Chan Knew the Representations were False

[915] Knowledge of the falsehood of the representation can take several forms:

(a) the defendant knew the statement was false;

(b) the defendant lacked an honest belief in its truth; or

(c) the defendant made the statement recklessly and did not care whether it was true or false.

[916] Mr. Chan was clearly aware of the falsity of his representations. Mr. Chan knew that he and Inside Management substantially and falsely inflated the revenues, profits and assets of Sino-Forest. He knew that Sino-Forest lacked the documents necessary to prove the ownership and location of the standing timber that constituted so much of the company's recorded wealth.

[917] Mr. Chan's motive or intention is immaterial. All that is required is that Mr. Chan was aware of the falsity of the representations, lacked an honest belief in their truth or was reckless as to their truth: *Bruno Appliance and Furniture Inc. v. Hyrniak*, 2014 SCC 8, 2014 1 S.C.R. 126, at para 18, quoting *Derry v. Peak* (1889), 14 App Cas 377 (HL) at 374.

(iii) Mr. Chan's False Representations Caused Sino-Forest to Act

[918] Whether Sino-Forest actually relied on the false representations is a question of fact that may be inferred from all the circumstances. The plaintiff is not required to show that the false representation was the sole inducement of Sino-Forest's actions but only that it was a material influence. If the defendant's misrepresentation was calculated to induce reliance or had the natural effect of inducing reliance, the Court can infer that the plaintiff relied on the misrepresentation from all the circumstances. If a misrepresentation is obviously material, it is a natural inference that the plaintiff relied on it.

[919] Mr. Chan's false representations caused Sino-Forest to raise billions and to entrust Mr. Chan and Inside Management with these funds. Between 2007 and 2010, Sino-Forest raised in excess of USD$2.1 billion and CAD$800 million in Canada's debt and capital markets. Sino-Forest relied on Mr. Chan's representations about the legitimate nature of the business operations in deciding to raise these funds, incurring obligations to lenders and shareholders and entrusting the funds to Mr. Chan. Mr. Chan's representations were material. The evidence is clear that the Sino-Forest relied on them. I find that Sino-Forest never would have entrusted the company and its assets to Mr. Chan in the absence of the fraudulent misrepresentations.

(iv) Sino-Forest's Actions Resulted in a Loss

[920] As discussed in more detail below, the actions that Sino-Forest took in reliance on Mr. Chan's false representations caused it to lose billions of dollars.

[921] The fact that Mr. Chan may not have personally profited from every transaction is not a defence. The defrauding party need not have profited from his or her fraud to be held liable. A plaintiff can suffer damages whether or not the defendant has personally benefitted.

Breach of Fiduciary Duty

(i) Mr. Chan Owed Fiduciary Duties to Sino-Forest

[922] As the CEO, a director and Chairman of the Board of Sino-Forest, Mr. Chan owed the Sino-Forest fiduciary duties. Mr. Chan was charged with managing the assets of Sino-Forest honestly and in a manner consistent with the objects of the corporation. Mr. Chan's fiduciary duties included an obligation: (a) to act in good faith and in the best interests of the corporation; (b) not to abuse his position for personal gain; and (c) to avoid conflicts of interest with the corporation. Directors and officers must serve the corporation selflessly, honestly and loyally: *Canada Business Corporations Act*, R.S. 1985, c. C-44, s. 122; *People's Department Stores Ltd. (1992) Inc.* (*Re*), 2004 SCC 68, at para. 35.

(ii) A Trustee-Like Position in Relation to Sino-Forest

[923] As CEO, director and Chairman, Mr. Chan owed fiduciary duties akin to those of a trustee because he exercised control and management over Sino-Forest's assets. Corporate directors are not true trustees. They are, however, in a closely analogous position. The duties of loyalty and good faith that they owe to the corporation are akin to those imposed upon trustees. The obligations of directors who are involved in the control and management of corporate assets are closely analogous to those of trustees in relation to trust property. Directors and officers who manage or control property of the corporation have an obligation to ensure that property is used in furtherance of specified purposes of the company. For this reason, a misapplication of corporate assets by a director can be akin to a breach of trust.

[924] Mr. Chan owed fiduciary duties towards Sino-Forest akin to the obligations of a trustee because of the high degree of control and management that he exercised over Sino-Forest's assets. As set out in detail above, Mr. Chan orchestrated all the transactions which ultimately led to Sino-Forest's collapse. He gave instructions and authorization to the activities of other members of Inside Management. Mr. Chan had ultimate control over nearly all aspects of Sino-Forest's operations and very little, if any, decision-making occurred without his knowledge and approval.

(iii) Breach of Fiduciary Duty

[925] Mr. Chan breached his fiduciary duties to the corporation. He violated his duty to act in good faith with a view to the best interests of the corporation by pursuing his personal interests and those of his friends and associates. He abused his position for personal gain by making personal profits from transactions that harmed the corporation and funnelling funds to entities that he controlled or benefited from. He violated his duty to avoid conflicts of interest by causing the payment of Sino-Forest funds into transactions with corporations that he secretly beneficially owned or controlled.

Negligence/ Duty of Care

[926] Although breach of Mr. Chan's duty of care as an officer and director of Sino-Forest was pleaded in the alternative, very little of the evidence or argument was directed at this particular cause of action.

[927] A basis for liability in negligence has not been established. The claim for damages for negligence is therefore dismissed.

Damages

[928] The basic measure of damages in tort is the difference between the financial position of the plaintiff as a result of the tort and the financial position of the plaintiff as it would have been if there had been no tort. In the tort of deceit (fraud) the compensable results of the tort are not limited to results that are of the type that should have been reasonably foreseeable by a person in the position of the defendant at the time the defendant committed the tort. Rather, while they include all the results of the type that should have been foreseeable, they go beyond that to the unforeseeable type of results that nonetheless flow from the deceit, only stopping when, on a common sense view, the chain of causation is broken by becoming too attenuated or by a new, intervening cause: *Rainbow Industrial Caterers Ltd. v. Canadian National Railway*, (1990) 67 D.L.R. (4th) 348 (B.C.C.A.), at para 36, aff'd 1991 SCC 27.

[929] Under this principle Mr. Chan is liable to pay damages for all losses caused by his fraudulent conduct, even if such losses were unforeseeable. The general principle in assessing damages in tort is the amount required to restore the plaintiff to the position the plaintiff would have been in if the tort had not occurred.

Causation

[930] In all claims for damages, the plaintiff must prove a causal relationship between the conduct which constitutes liability and the losses suffered. Determining causation requires the exercise of common sense. The Court may make an adverse inference against the defendant where the defendant fails to rebut the plaintiff's case, or if the defendant's own wrongdoing has made it difficult to assess causation.

[931] Causation in tort law is essentially a practical question of fact which can best be answered by ordinary common sense rather than abstract metaphysical theory. Causation in tort does not require scientific or precise proof. Courts apply the "but for" causation test in a robust, common sense manner. If the plaintiff adduces evidence connecting the defendant's breach of duty to the plaintiff's injury, the court may infer that the defendant's tort caused the loss even in the absence of scientific evidence of the defendant's precise contribution: *Snell v. Farrell,* [1990] 2 S.C.R. 311. The legal burden remains with the plaintiff, but in the absence of evidence to the contrary adduced by the defendant, an inference of causation may be drawn although positive or scientific proof of causation has not been adduced: *Snell,* at para. 34.

[932] When the plaintiff adduces evidence connecting the defendant’s tortious conduct to the injury suffered, it is appropriate for the court to infer the defendant’s liability for these injuries in the absence of a credible explanation by the defendant. Evidence is to be weighed according to the proof which it was in the power of one side to have produced and in the power of the other to have contradicted: *Blatch v. Archer* (1774), 98 E.R. 969, at p. 970.

[933] This is especially the case where the facts lie particularly within the knowledge of the defendant. The Court may infer causation in the absence of evidence to the contrary. The Court may make such inferences even if the plaintiff adduces little affirmative evidence and lacks positive or scientific proof of causation. The Court may make an adverse inference against the defendant if the defendant fails to provide a credible explanation to rebut the evidence adduced by the plaintiff. This is not a reverse onus. Instead, it is merely the application of a “robust and pragmatic approach to the…facts” and is consistent with the trial judge’s fundamental role in weighing evidence: *Snell*, at paras. 33-34.

[934] Canadian courts have applied this basic evidentiary principle to fraud and breach of fiduciary duty. Adverse inferences may be drawn against defendants as long as the plaintiff has made reasonable efforts to adduce evidence to link the defendant’s conduct to the harm suffered and the defendant provides no credible explanation. The court assessing damages will not demand exacting proof of the precise loss from fraud or breach of fiduciary duty, but instead draw an adverse inference against a defendant found to have been fraudulent or in breach of fiduciary duty unless that defendant leads evidence to disprove the amount or cause of the loss, *Huff v. Price*, (1990) 76 D.L.R. (4th) 138 (B.C.C.A.), at para. 38.

[935] It is also a well-established legal principle that the Court is entitled to resolve evidentiary difficulties against the wrongdoer who created them. As the Ontario Court of Appeal ruled in *Ticketnet Corp v. Air Canada*, (1997) 105 O.A.C. 87, at para. 85: evidentiary difficulties should be resolved against the wrongdoer “where the wrongdoer’s own actions make it difficult for the innocent party to prove its loss or where the facts needed to prove the loss are known solely by the wrongdoer and the wrongdoer does not disclose these facts to the innocent party.” The Court of Appeal cited the Supreme Court of Canada in *Kohler v. Thorold Natural Gas Co*, (1916) 52 S.C.R. 514, at 530-31, where Duff J. held:

> [A]s against a wrongdoer, and especially where the wrong is of such a character that in itself it is calculated to make and does make the exact ascertainment of damages impossible or extremely difficult and embarrassing, all reasonable presumptions are to be made.

See also *581257 Alberta Ltd. v. Aujla*, 2013 ABCA 16, 542 A.R. 123, at para. 56.

[936] It is not necessary that the defendant’s actions be the sole cause of the injury. As long as the defendant is part of the cause of an injury, the defendant is liable for all loss suffered by the plaintiff even if the defendant’s act alone was not enough to create the injury. All that is required

to establish "but for" causation is that the defendant caused or contributed to the plaintiff's injury, and the existence of other preconditions does not provide the defendant any defence.

[937] In this case, Sino-Forest's collapse was triggered by the revelations in the Muddy Waters Report but was caused by the inability of the company to demonstrate that:

(a) it owned BVI standing timber assets worth $2.9 billion; and

(b) its standing timber and wood log trading operations were *bona fide*, conducted with arm's-length counterparties at fair market value.

It could not do so because, as I have found, through Mr. Chan's fraud and breach of fiduciary duty, Sino-Forest did not own standing timber worth $2.9 billion and engaged in secret, related-party transactions.

[938] Mr. Chan concealed the use of non-arm's-length counterparties and the diversion of funds to those counterparties in the form of the wood log skimming and deposit frauds. The relative success of his concealment cannot be a basis for denying the plaintiff damages.

[939] It has been proved, on a balance of probabilities, that Sino-Forest did not own BVI standing timber assets worth anything close to $2.9 billion. It has also been proved on a balance of probabilities that Sino-Forest's BVI standing timber and wood log trading operations were not *bona fide* and were not conducted with arm's-length counterparties. Mr. Chan directed a massive fraud, in breach of his fiduciary duties to the company, in which he caused Sino-Forest to misrepresent its assets (it did not own 520,000 ha of BVI standing timber) and their value (the BVI standing timber "asset" had no value).

[940] In my view, the causal link between Mr. Chan's misfeasance and the total collapse of Sino-Forest has been established on the evidence.

Determining the Quantum of Damages

[941] The question then becomes, how to calculate a value for the attendant loss?

[942] Much like causation, the determination of quantum is also a matter of common sense. The Ontario Court of Appeal has held that where damages are by their nature difficult to assess, the court "must do the best it can in the circumstances." The plaintiff has an onus to prove the facts upon which damages are estimated but where the assessment is difficult because of the nature of the damage proved, the difficulty of assessment is no ground for refusing substantial damages, "even to the point of resorting to guess work," *Martin v. Goldfarb*, (1998) 41 O.R. (3d) 161, at para. 75. The difficulty of determining quantum can never excuse the wrongdoer from paying damages.

[943] It follows that determining quantum is a process of holistic assessment, not precise mathematical calculation. While expert evidence is admissible and may be useful, assessment of

damages is ultimately a task for the court and not for accountants or other mathematical and statistical experts.

[944] As long as the plaintiff makes reasonable efforts to assess quantum, it will fall to the defendant to lead evidence to disprove the amount of the loss. The plaintiff's obligations to adduce evidence are determined by the circumstances and the plaintiff is not required to do more than is reasonably possible: see *Martin* at para. 75.

[945] The central complicating factor in the calculation of damages in this case is that the BVI standing timber model was essentially a cashless model. Due to the unique characteristics of foreign (BVI) companies operating in China and foreign currency controls, the BVI standing timber model was based on ploughing paper profits back into the purported acquisition of ever greater stands of timber in China. Little or no money came into or went out of Sino-Forest in connection with trading in BVI standing timber itself. When Sino-Forest bought a plantation from a Supplier, it sold another plantation to an AI. Sino-Forest did not pay the Supplier for the new plantation. Sino-Forest did not receive payment from the AI on the sale of the old plantation. Rather, Sino-Forest directed AIs to pay Suppliers, not Sino-Forest.

[946] Sino-Forest's asset base in BVI standing timber grew, but Sino-Forest received no cash flow on these transactions. At one level, therefore, one could argue that, upon the collapse of the BVI standing timber model, Sino-Forest suffered no loss. It paid nothing for the asset so if the asset turned out not to exist, or to have no value, Sino-Forest suffered no damage.

[947] This approach would ignore, however, the effect of having carried the BVI standing timber assets on the books of the company – an asset which, by 2011, was valued at $2.99 billion.

[948] From a financial perspective, the largest impact of representing this value of Sino-Forest's principal asset in its audited financial statements was that it enabled Sino-Forest to go to the capital markets and raise money. The damages experts do not disagree over this at least – the Sino-Forest business model required cash infusions for operating expenses precisely because the BVI standing timber model generated no cash revenues. Indeed, I accept the evidence of Mr. Borrelli and Steger that Sino-Forest was, in fact, loss-making in all years from 2005 to 2011 when the effect of paper profits generated through trading in BVI standing timber is removed from Sino-Forest's books.

[949] This gives rise to one of the central disputes between the parties over damages quantification. Steger seeks to step over this problem by calculating the loss, not as a function of specific losses resulting from specific fraudulent activities or the tracing of funds into Mr. Chan's hands, but by looking at:

(a) the difference between the amount raised on the capital markets and the ultimate demonstrated value of Sino-Forest's undertaking; and

(b) the amount by which Sino-Forest's assets were written down following the various investigations and attempts at realizing value that took place between June 2011 and the CCAA proceedings in 2013.

[950] The defendant's damages expert, Ratner, argues that a critical flaw in Steger's methodology is the failure to calculate damages on a fraudulent activity by fraudulent activity basis. I will turn to that dispute in the next section of these Reasons.

Steger Evidence

[951] Sino-Forest issued its last audited financial statements as of December 31, 2010 and its last unaudited financial statements as of June 2011. Sino-Forest operated under Mr. Chan's leadership until he resigned in August 2011. Steger used June 30, 2011 as a proxy for the end of the period Sino-Forest was under the direction of Mr. Chan.

[952] Sino-Forest continued to operate on a progressively reduced basis until March 2012 when it filed for and obtained orders under the CCAA. Some adjustments were therefore required to reflect the limited impact of post-Chan business activity on the June 30, 2011 cash balances.

[953] Steger was retained to calculate damages on behalf of the plaintiff. He performed two loss calculations. First, he calculated the loss suffered from Mr. Chan's malfeasance as the difference between:

(1) the cash Sino-Forest raised from the debt and equity issues between 2004 and 2010. This was cash, Steger posited, that would have been available to invest in profit generating assets but for Mr. Chan's actions; less

(2) the actual cash recoveries from the sale of Sino-Forest's assets, (the "lost cash calculation").

[954] Second, Steger traced, and summarized, the write-downs suffered by Sino-Forest on the false and inflated asset values perpetrated by Mr. Chan's actions. This, Steger calculated as the difference between:

(a) the reported value of Sino-Forest's assets of as of June 30, 2011; and

(b) the net realized value of those assets following Mr. Chan's departure,

(the "write-down calculation").

(i) The Lost Cash Calculation

[955] Sino-Forest raised gross proceeds in the debt and equity markets of $2.929 billion from 2004 to 2010. From these proceeds, Sino-Forest incurred share and debt issue costs and made

certain principal debt repayments. The net cash available to Sino-Forest after payment of these costs was $2.588 billion.

[956] Steger assumed that available cash would have been deployed in profit-making investment of some kind, at a rate at least sufficient to cover the cost of Sino-Forest's debt and its debt and equity issuing costs. This "proxy" return, the cost of debt and the debt and equity issue costs, was $477.8 million. Thus, total cash assumed to be available to Sino-Forest was $3.065 billion.

[957] To date, EPHL has recovered only $438.5 million from its disposition of all of Sino-Forest's assets.

[958] Based on this analysis, Steger concluded that, but for Mr. Chan's fraudulent activity, Sino-Forest would have had $2.588 billion available for investment in profit-generating assets. To that amount, Steger added the proxy return of $477.9 million, for a total of $3.065 billion. Because EPHL recovered $438.5 million for all of Sino-Forest's assets, Steger credited that amount against the total, to calculate Sino-Forest's loss at $2.627 billion.

(ii) The Write-down Calculation

[959] Sino-Forest also had cash flows from operations. It generated cash receipts from some of its business activities and spent cash on operating costs, log purchases and the like. Sino-Forest paid no dividends.

[960] Both Mr. Borrelli and Steger determined, through different methodologies, that from 2005 to 2010, Sino-Forest generated little or no positive net cash flow. Mr. Borrelli reversed from Sino-Forest's general ledger the effects of the alleged fraudulent activity in the BVI standing timber model, the wood log skimming and the wood log deposits. He concluded that after these adjustments, Sino-Forest would have been reporting net losses in each year from 2005 to 2010.

[961] Steger reviewed Sino-Forest operations at the financial statement level. His analysis showed that Sino-Forest's cash flows and accounting income were solely on account of the cash raised from the debt and equity markets and paper gains on BVI standing timber trading converted into ever increasing BVI standing timber asset values. Based on this analysis, for example, when the BVI standing timber trading "profits" are excluded, Sino-Forest should have shown a loss of $365.1 million in 2010 rather than the $840.1 million profit reported in the audited financial statements.

[962] Sino-Forest's reported assets, specifically for BVI standing timber, accounts receivable, log deposits and investments in GRHL of June 30, 2011 were $3.8 billion.

[963] The value of the assets transferred to EPHL on January 30, 2013 was only $564.8 million. This $3.2 billion reduction reflected the write-downs made, following Mr. Chan's departure, to estimated net realizable value. This was mostly the write-down of BVI standing timber assets, a

write-down of some $2.77 billion.[9] This write-down reflected EPHL's conclusion that Sino-Forest did not own and could never realize economic value from its BVI standing timber assets.

[964] In Steger's alternative approach, therefore, he calculated total write-downs suffered by Sino-Forest (on what he assumed for the purposes of his analysis, were false or inflated values of BVI standing timber assets, receivables and wood log deposits) as follows:

BVI Standing Timber	$2,777.5 million
Accounts Receivable	$368.9 million
Log Deposits	$101.8 million
Total	$3,244.3 million

[965] Steger recommended adopting the "lost cash" calculation – a loss of $2.627 billion, rather than the "write down" calculation of $3.244 billion.

Ratner Evidence

[966] Mr. Ratner of Glass Ratner Advisory & Capital Group LLC, a forensic accounting firm based in Atlanta, Georgia, was initially retained to assist another forensic accounting firm, Froese Forensic Partners, to provide independent forensic accounting and loss quantification advice in relation to this action. In the end, Mr. Froese did not testify, so only Mr. Ratner's opinion was before the Court.

[967] Ratner was asked to do three things:

(1) review the Steger report and provide comments on Steger's report and on Steger's reliance on Mr. Borrelli's pre-filed evidence;

(2) review and analyze data and other information relevant to the loss quantification; and

(3) prepare a report setting out his findings and conclusions.

Ratner did not prepare a loss quantification report of his own and offered no opinion on Sino-Forest's loss beyond his critiques of Steger's analysis.

[9] The difference between this number and the $2.99 billion referred to earlier in these Reasons is one of timing. The $2.7775 billion figure is the value of the BVI standing timber taken from the EPHL financial statements immediately prior to being written down to nil in 2013. The $2.99 billion value is the value of the BVI standing timber recorded in Sino-Forest's financial statements as of June 2011, immediately prior to the release of the Muddy Waters Report.

[968] At the heart of Ratner's criticism of the Steger report is Steger's implicit assumption that all of the cash raised on the capital markets from 2004 to 2010 was lost due to Mr. Chan. Ratner says that while this approach may have merit in a simple theft or Ponzi scheme scenario, it is too simplistic in the circumstances of this case, given that Sino-Forest operated numerous legitimate businesses.

[969] Ratner argues that Steger made the following five basic errors in his analysis:

(1) Steger used an inappropriate and flawed damages methodology, given the facts and circumstances in this matter, that results in the overstatement of potential damages;

(2) Steger failed to investigate and quantify the damages contended to have been suffered by Sino-Forest that "but for" the alleged actions of Mr. Chan, would not have been incurred;

(3) Steger failed to trace funds paid to Mr. Chan to his benefit;

(4) Steger appears to have calculated damages that duplicate those claimed by the debt and equity holder plaintiffs in a separate class action; and

(5) Steger relied on the Borrelli affidavit in significant aspects of alleged wrongdoing by Mr. Chan where Mr. Borrelli chose to ignore contrary facts that provide reasonable explanations for the actions of Mr. Chan.

(i) Flawed Methodology

[970] Ratner argues that Steger used an inappropriate and flawed damages methodology given the facts and circumstances in this matter that results in the overstatement of potential damages. Ratner makes the following specific criticisms on this issue:

(1) the selection of an appropriate measure of damages is dependent on the unique facts and circumstances of each specific case. Steger's damage approach and methodology does not consider the unique facts and circumstances relevant to this case. Instead, he implicitly assumes Sino-Forest's entire operations were equivalent to a Ponzi scheme or theft and measures damages as the net cash losses realized by Sino-Forest's debt and equity investors;

(2) for purposes of assessing Sino-Forest's losses, Steger explicitly assumes that Mr. Chan is solely liable for those losses. This assumption results in Steger failing to investigate or consider specific causal links, if any, between the alleged actions of Mr. Chan and Sino-Forest's damages;

(3) Steger failed to perform any analyses or identify any verified evidence that Sino-Forest had the attributes of a classic Ponzi scheme or fraudulent investment scam

to support his assumption that Mr. Chan is solely responsible for Sino-Forest's losses;

(4) Steger's damage methodology fails to consider mitigation and overstates cash damages by approximately $645 million representing the reduction in cash that occurred during the post-Chan period which was not caused by the alleged actions of Mr. Chan;

(5) Steger's damages methodology further overstates damages by hundreds of millions of dollars representing the portion of debt and equity capital raised that was used to acquire legitimate operating business assets such as Homix, Mega Capital, Greenheart Group Limited, Mandra Forestry Limited, WFOE standing timber and planted plantations, and other capital assets, irrespective of the subsequent liquidation value of those assets;

(6) Steger further overstates damages by improperly applying zero value to a significant portion of Sino-Forest's assets transferred to EPHL (i.e., the BVI standing timber) instead of properly using the fair value of those assets, which are higher than zero; and

(7) while there are differing viewpoints and opinions among the parties as to the actual value of almost $2.8 billion of BVI timber assets written down to zero, Steger only acknowledges that the actual value recovered in the future would reduce his damages. However, Steger did not apply an estimate for that future value and did not reduce his damages by the arbitration award against Xunxiang. Ratner argues full credit should be given for the face amount of the Xunxiang arbitration award ($87 million), not just the amount actually recovered by EPHL of $10 million.

(ii) Failure to Investigate

[971] Ratner argues that Steger failed to investigate and quantify the damages contended to have been suffered by Sino-Forest that "but for" the alleged actions of Mr. Chan, would not have been incurred. Ratner argues that:

(1) Steger's assumption that all of Sino-Forest's debt and equity cash raises were wholly lost due to the alleged actions of Mr. Chan is contradicted by the economic realities that some of those proceeds were used to acquire other operating assets and some losses were caused by external economic and industry factors;

(2) accordingly, Steger should have identified and investigated the specific fraudulent transactions allegedly caused by Mr. Chan and then properly quantified the elements of damage associated with those transactions. This approach would involve a series of analyses based on evidence rather than using a blanket, unproven assumption about liability that is contradicted in many instances by other facts and circumstances;

(3) moreover, the "but for" methodology requires the expert to consider and quantify the impact of external factors on the damages calculated. In other words, the expert must consider if external factors such as the economy, regulatory issues, competition, or the industry, to name a few, accounted for some portion of the losses. Steger performed no such analyses;

(4) had Steger performed an industry analysis, he would have determined there was significant evidence that certain external factors such as climate, industry pricing, and lack of a registration system for certificates of title contributed to significant valuation losses that were systemic to the industry and not caused by the alleged actions of Mr. Chan; and

(5) the failure to consider and quantify losses from climate, economic, regulatory, or other industry factors overstates damages by the amounts attributed to those factors.

(iii) Failure to Trace Funds to Mr. Chan

[972] On the issue of Steger's failure to identify specific frauds allegedly committed by Mr. Chan and to trace funds paid to his benefit, Ratner argues:

(1) there is a disconnect between the order of magnitude of damages calculated by Steger of approximately $2.6 billion and the absence of evidence or tracing of funds directly benefitting Mr. Chan, whose alleged actions purportedly caused the damages;

(2) even on the basis of Steger's assumption that Mr. Chan is liable for all of Sino-Forest's cash losses, Steger does not investigate or trace the $2.6 billion of alleged cash losses arising from the alleged fraud to the direct benefit of Mr. Chan;

(3) Steger's calculation of cash losses of $2.6 billion is contradicted by analysis of cash uses that shows an increase in cash of $1.2 billion over the 2004 to 2010 period and cash used for acquisitions and other transactions not disputed by Steger totaling an additional $1.4 billion.

(iv) Duplication of Damage Claims

[973] Ratner argues that Steger has calculated damages that duplicate those claimed by the debt and equity holder plaintiffs in a separate class action. Specifically, Ratner argues:

(1) Steger's approach to damages incorrectly includes claims excluded from the Sino-Forest Litigation Trust that appear to have been reserved exclusively for the securities class action. In duplicating these claims, he fails to consider or account for the economic impact of those non-trust claims thereby demonstrating a

fundamental flaw in his damage methodology that duplicates the damages across two sets of claims;

(2) Justice Perell certified the class action claim and set out the causes of action against each defendant, and discussed the many common issues of fact in the class action plaintiffs' claims; and

(3) as such, the class action is now certified and authorized to move forward with those specific claims against Mr. Chan, among others, related to the sale of the securities and seeking to recover the value of their investments. Despite the fact that these claims are specifically reserved exclusively for the class action, Steger appears to have effectively calculated his damages to include these claims.

(v) Reliance on Mr. Borrelli's Evidence

[974] Ratner argues that Steger unreasonably relied on the Borrelli affidavit for all of the significant aspects of alleged wrongdoing by Mr. Chan. Steger did not evaluate whether Mr. Borrelli had chosen to ignore contrary facts that provide reasonable explanations or were helpful to Mr. Chan.

Analysis

[975] In my view, most of Ratner's criticisms of Steger's approach:

(a) proceed from a misconception of what Steger was asked to do;

(b) involve Ratner's view that certain evidence, which supports Mr. Chan's defence on liability, was not given sufficient consideration. This, it seems to me, exceeds the viable scope of the expert's role on damage quantification by getting into disputed facts going to liability; or

(c) are founded on legal argument, again not an issue for expert opinion.

The most significant criticisms fall into six general categories. I will address each of them below.

i) Assumed Liability

[976] Ratner, in proposing many of his criticisms, raises various alternative factual scenarios and refers to evidence relied upon by Mr. Chan as not having been given sufficient consideration in Steger's report.

[977] This misconceives the nature of Steger's assignment. The question of whether there was a fraud or a breach of fiduciary duty is not for Steger (or Ratner, for that matter) to decide. That issue is the principal issue of fact before the Court, on which I heard evidence for over 40 days (only three or four of which involved expert evidence on damages).

[978] A prime example of Ratner's approach involves the question of whether Steger should be criticized for having assumed the BVI standing timber assets have zero value. Ratner points to some of the evidence (relied upon by Mr. Chan) in support of the position that the BVI standing timber assets do have value. An example is Ratner's reference to the Moelis report.

[979] The problem is that whether or not the BVI standing timber assets exist and whether they have any value is a central disputed issue of fact in this case. It is not a matter for Ratner, or Steger, to decide. Most of this trial is has been consumed with the question whether Sino-Forest owned the BVI standing timber assets and what if any value these assets had. Six years after the fact, Mr. Chan has come forward with no evidence that the former Sino-Forest BVI standing timber assets (now "owned" by New Plantations) have been identified, located or had their ownership confirmed, much less monetized. I have found as a fact that Sino-Forest did not own the BVI standing timber asset and that its value was nil.

[980] Ratner agreed in cross-examination that the best indication of value is what an arm's-length purchaser is willing to pay. The pre-CCAA attempt to sell the BVI standing timber assets produced nothing. The Monitor's efforts to identify value while Sino-Forest was under court supervision also produced nothing. EPHL, although highly motivated to realize the highest possible value, wrote the BVI standing timber assets down to nil. This was supported by EPHL's auditors, KPMG.

[981] The one piece of evidence Ratner points to as demonstrating a "flaw" in Steger's methodology is what was described in the evidence of Brough as a "marketing" piece prepared by Moelis. The Moelis document suggests there may be value in the BVI standing timber. This was prepared for the consideration of Danny Wu, one of the principals brought to the 2016 EPHL deal by Mr. Chan himself. It is Mr. Chan, and no one else, who has steadfastly maintained the BVI standing timber assets exist and have value. New Plantations, in the end, did not conduct any material due diligence on the BVI standing timber and paid nothing for it. The RAPA, which covers any realizations on BVI standing timber, has yet to produce any payouts. The Moelis document is not evidence that the BVI standing timber asset was real.

[982] Steger's reliance on Mr. Borrelli's evidence is, as noted above, not an appropriate criticism of Steger, as such. Mr. Borrelli's evidence merely engages the central factual issues in this case. That is not a question for the damages experts.

[983] Steger candidly admitted in his written and oral evidence that liability was assumed in his analysis. If liability were not proved, he said, his analysis of damages would have no application. Ratner's criticism on this point is, in my view, attacking Steger for something he was not asked to do. It also assumes Mr. Chan's evidence and arguments on liability; this goes beyond the competence of a damages expert to address. In wading into this issue, Ratner has, in my opinion, trespassed into questions of disputed fact on the issue of liability which are beyond the scope of a damages enquiry.

[984] In this respect, Steger's opinion is no different from the opinion of virtually all experts; it proceeds on the basis of assumed facts. Here, the assumed facts are specifically related to liability on the basis advanced by the plaintiff in this lawsuit.

[985] Ratner sought to advance evidence supportive of Mr. Chan's defence on liability. The factual matters referred to by Ratner were the focal point of much of the evidence at trial. I have found that the essential factual underpinnings of Steger's opinion have been established on the evidence. I have found that most of the factual assertions pointed out by Ratner have not been established.

ii) Post-Chan Loss of $644 Million

[986] Ratner argues that Steger's damage report fails to take account of a $644 million cash reduction that took place post-Chan. Steger explains this, however, on the basis that he did take account of certain specific post-Chan losses, but these are minimal. The bulk of these expenditures was incurred in respect of commitments made during Mr. Chan's management or expenditures incurred in the course of Sino-Forest's collapse, including investigation costs, CCAA costs and the cost of EPHL's recovery activities. Whether these losses are attributable to Mr. Chan is a question of law, causation and foreseeability, not a question for damage quantification.

[987] The defendant says, as well, that of the $644 million spent between June 2, 2011 and January 31, 2013, the largest single amount, $188 million, was paid out to the "senior note holders." The defendant argues that Mr. Chan could not possibly be responsible for the payment out, by Sino-Forest, of this amount, as Sino-Forest was "legally required" to pay it under the terms of the debt instruments. Including this $188 million in the amount for which Mr. Chan is found liable would result, he says, in double recovery.

[988] One of Mr. Chan's witnesses, Dickson Chau, testified that he was hired by New Plantations to review the cash payments made out of the $898 million cash available to Sino-Forest after June 2, 2011. He found that $644 million was spent. The focus of Chau's affirmation and his viva voce evidence at trial was the amount spent on professional fees – $137 million. No mention was made of the payments to senior note holders. No supporting documents were provided. Chau simply says in his supplementary affidavit that, as part of his investigation, he prepared a spreadsheet containing the information obtained and/or verified during his investigation. He said he inadvertently forgot to attach the spreadsheet to his first affirmation (which highlighted the professional fees issue). Chau therefore attached the spreadsheet to his supplementary affirmation. Buried in the spreadsheet on the seventh page is one line styled "senior noteholders." It contains one entry – $188,405,456 with the notation, "senior notes – repayment and interest, other waiver fee."

[989] The defendant raised this issue for the first time in written argument. It was not referred to in oral argument.

[990] I tend to agree with the defendant as a matter of principle that if some of the $898 million in cash available after June 2, 2011 was used to pay off debt obligations, that expenditure could not properly be characterized as a "loss" to Sino-Forest caused by Mr. Chan's fraud or breach of fiduciary duty.

[991] Steger, conceptually at least, also agrees with this because, in his analysis of the period prior to the CCAA proceedings, he deducted from the amount raised in the capital markets the amount used to make principal repayments between 2009 and 2012 of $237.670 million to reach the net cash available from capital raises.

[992] The problem with the defendant's argument lies in the manner in which it came before the Court. I am not satisfied that one line in an Excel spreadsheet prepared by Chau in the context of addressing a very different issue, without any supporting original documents or entries, constitutes proof on a balance of probabilities that $188 million was actually paid to the senior noteholders out of available cash between June 2, 2011 and January 31, 2013. Steger's report does not itemize when or in what amounts particular repayments of debt were made which make up the $237 million total repaid from 2009 to 2012. Steger does say, however, that these calculations are based on repayments made "prior to the CCAA proceedings." Chau's spreadsheet also contains expenditures up to January 31, 2013, the effective date of the CCAA plan (the initial order was made March 30, 2012).

[993] It is likely, therefore, that, even if Chau's spreadsheet is accurate, the $188 million allegedly paid to Sino-Forest's debtholders, is already credited within the $237 million reduction made by Steger to reach net cash available from the capital raises. The defendant's evidence simply does not address this issue.

[994] For these reasons I am not prepared to adjust Steger's calculations to make any further reduction for this item.

iii) The Legitimate Businesses

[995] Ratner complains that Steger failed to account for the fact that Sino-Forest operated some unambiguously legitimate businesses and spent some of the cash raised acquiring, operating and maintaining these assets. If trading losses resulted from the acquisition and later disposition of these legitimate businesses, the defendant argues, that loss was not caused by the defendant's fraud and should not be included in any calculation of damages against him. Steger's analysis, in my view, does account for this. All of Sino-Forest's viable businesses and assets were sold. The benefit of those assets is embodied in the purchase price paid by New Forest and New Plantations in arm's-length transactions on the open market, following whatever due diligence they deemed appropriate.

[996] It must also be remembered that Sino-Forest's investments in low marginal value assets, such as WFOE planted plantations, although legitimate businesses, were used to mask the significant frauds being perpetrated in the BVI standing timber and wood log trading businesses.

The cost of employees, facilities and the like, although they cannot be traced to Mr. Chan's personal benefit, were necessary to enable the fraudulent BVI standing timber model to continue undetected. The risk of market value loss on the sale of such assets should, in the circumstances, fall on the defendant.

[997] In a similar vein, the defendant argues that the plaintiff has not proved that any of the impugned transactions did not take place at fair market value. In my view, fair market value is largely irrelevant in the circumstances of this case. I say this because the plaintiff does not argue that the amounts paid for assets were not at fair market value. Rather, for example, in the context of wood log trading deposits, the plaintiff alleges that Mr. Chan caused Sino-Forest to divert funds to non-non-arm's length entities that he secretly controlled, knowing that logs would never be delivered. Or, in the context of BVI standing timber trading, the plaintiff accepts, indeed relies upon the fact, that no funds were transferred at all.

[998] The one possible exception is the Greenheart/GRHL acquisitions. The plaintiff alleges that Mr. Chan caused Sino-Forest to invest $202 million in this acquisition when he had an undisclosed interest and knew the business was not viable. Following the CCAA plan, Greenheart was sold to New Forest for $108.5 million, resulting in a loss suffered by Sino-Forest of $93.5 million.

[999] Ratner says Steger erred by overstating Greenheart losses in two ways:

(1) there was a good business case for the investment; and

(2) Steger's loss calculation is based on the value of Greenheart when it was sold in 2014, not when it was acquired in 2007.

[1000] The first issue is a question of fact on a disputed issue. It is not for Ratner (or Steger) to say whether there was a good business reason for Sino-Forest to invest in Greenheart in 2007. I have already found, earlier in these Reasons, that Mr. Chan's interest in Greenheart (through Montsford and Fortune) was not disclosed and that he caused Sino-Forest to enter into the Greenheart acquisition with a blatant, undisclosed conflict of interest. I have also found that, due to his lengthy and intimate investment in Greenheart prior to Sino-Forest's investment, Mr. Chan had a detailed knowledge of the frailty of Greenheart's business and financial position, which he likewise did not disclose to Sino-Forest.

[1001] Further, as Steger pointed out in his reply report:

- Sino-Forest paid effectively $9 million in July 2007 to GRHL at a time when GRHL only had a modest concession right previously purchased in 2005 at $1.2 million and as at December 31, 2006 GRHL only had inventory worth $986,000; and

- there is no evidence of any substantive wood deliveries under the 2007 Supply Agreement.

[1002] On the second issue, Ratner criticizes Steger for failing to take into account Poyry's "independent valuations" of the GRHL plantations. These criticisms are misplaced for the following reasons:

- The Poyry valuations are irrelevant to determining Sino-Forest's loss. Mr. Chan caused Sino-Forest to first invest in GRHL without disclosing to Sino-Forest his personal interests in GRHL or the problems it was facing. The fact that the Poyry valuations were obtained by Greenheart along the way is of no consequence. Mr. Chan, through his breach of fiduciary duty and fraud, caused Sino-Forest to invest money in the Greenheart Group which would otherwise not have been invested. The arithmetic is not in dispute – Sino-Forest suffered the cash loss calculated by Steger as a result of the Greenheart transactions. Mr. Chan is, I find, liable for that loss.

- In any event, Mr. Chan elected to call neither the GRHL representatives responsible for instructing Poyry to prepare the valuations he seeks to rely upon nor the Poyry employees responsible for preparing the valuations. Accordingly, it is not known what instructions Poyry received and what concerns Poyry might have articulated to GRHL management concerning matters they were instructed to assume. For example, as noted by Steger in his report, the 2007 Poyry valuation was prepared under instruction from Greenheart to adopt a "standing stock valuation." Poyry in its 2007 valuation specifically noted limitations in respect of this method of valuation – among other things, that it assumes all of the standing volume in a particular resource can be marketed at one specific point in time without impacting demand, prices or the related cost of doing so. Poyry assumed that "all the merchantable volume within the concession is harvested and sold at midnight 31st July 2007."

[1003] Ratner criticizes Steger for supposedly ignoring documents disclosing that the transactions were supported by approvals of the Sino-Forest Board of Directors. There is no documentary evidence that the Sino-Forest board of directors had prior knowledge of, let alone approved, Sino-Forest's initial acquisition in GRHL. Mr. Chan gave evidence at trial that he believed Judson Martin, a fellow director of Sino-Forest, was aware, among other things, of his discussions with Lui, Lei and others prior to Sino-Forest first investing "because he's a big supporter of Greenheart transaction."

[1004] Mr. Chan was forewarned during his cross-examination that Martin would be examined on what he knew and when he came to get such knowledge about Mr. Chan's various discussions with Lui, Lei and Lok. Mr. Chan elected late in the trial not to call Martin to give evidence despite my order that defence counsel could cross-examine Martin as opposed to leading his evidence in chief as would ordinarily be the case. As a result, Martin's evidence regarding the Greenheart Group is unknown. It is a reasonable inference that if Martin's evidence would have been helpful to Mr. Chan, Martin would have been called as a witness.

[1005] Ratner criticizes Steger's Greenheart loss calculation on the basis that, prior to the release of the Muddy Waters Report, Sino-Forest's investment in Greenheart was trading at prices above Sino-Forest's average cost per share. Greenheart's share price dropped post-Muddy Waters as it was "impacted by the negative publicity and allegations arising from its association with Sino-Forest."

[1006] Ratner argues that Steger inappropriately calculated Sino-Forest's loss based on a distressed sale price (i.e. the actual net proceeds received from the sale of Sino-Forest/EPHL's interests to Newforest post-CCAA). During his oral testimony, Ratner proposed that June 1, 2011 (i.e. pre-Muddy Waters) be the date used to "normalise the stock price." This, according to Ratner, would result in Sino-Forest making a $42.5 million gain from its Greenheart investment, rather than a loss.

[1007] It seems to me that this is a case where the principle of equitable damages applies: *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534, at paras. 67-68.

[1008] Mr. Chan was a fiduciary. He caused Sino-Forest to invest in Greenheart when he had an undisclosed interest. This was a breach of his fiduciary duty owed to Sino-Forest.

[1009] Mr. Chan's role as CEO and Chairman was not as a trustee, to be sure, but it was "trust-like." Mr. Chan's fiduciary obligation as the senior officer and director of Sino-Forest placed upon him the obligation to deal with Sino-Forest's property, including funds available, for the benefit only of Sino-Forest: *Guerin v. R.*, [1984] 2 S.C.R. 335, at para. 104.

[1010] Equitable compensation is determined by analogy to the principles of trust law. Equity is concerned with restoration of the actual value of the thing lost through the breach of duty, in this case Sino-Forest's funds raised on the capital markets. Equitable compensation is assessed at the date of trial, not, like common-law damages, at the date of the breach. And, equity presumes the trust funds will be invested in the most profitable way or put to the most advantageous use: *Whitefish Lake Band of Indians v. Canada (Attorney General)*, 2007 ONCA 744, 87 O.R. (3d) 321, at paras. 48-49.

[1011] Failure to disclose Mr. Chan's interest was a breach of Mr. Chan's fiduciary duty. Sino-Forest is entitled to be put in the position it would have been if the breach had not occurred, i.e., if the investment had not been made. Sino-Forest is not required to bear the risk of market fluctuation between the date of acquisition and the date of sale. The fact that the discovery of Mr. Chan's fraud had a negative effect on the market value of the Greenheart asset is not a market risk Sino-Forest has to bear. I therefore find that Sino-Forest was, in the circumstances, not required to prove that the Greenheart investment of $202 million was not at fair market value at the time was made. It is sufficient that Sino-Forest suffered a loss in fact, provided the realization was not improvident. There is no evidence that the sale of Greenheart to New Forest was an improvident realization in the circumstances.

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iv) Other Causal Effects

[1012] Ratner also argues that Steger failed to eliminate the possibility of other market forces or industry factors that might have contributed to Sino-Forest's loss. To the extent this argument seeks to encompass the problem of fire-sale prices in a bankruptcy, it is again a question of causation, foreseeability and, ultimately, law. Who bears the risk of lower than market values in a bankruptcy scenario is not for the damages expert to decide. In the circumstances of this case, I find it is Mr. Chan who bears that risk. He knew, or must be deemed to have known, that the discovery of his conduct would send Sino-Forest into a tailspin.

[1013] To the extent this argument contemplates completely external forces affecting market values in the forestry industry generally (such as typhoons or insect infestations), there is simply no evidence there were any external forces of this nature affecting value. It is not the plaintiff's obligation to exclude every possible contributor to a decline in value. The plaintiff has made his theory clear – the collapse of Sino-Forest was the result of Mr. Chan's fraud. The plaintiff has established there was a fraud and that over $2.7 billion in assets did not exist. It was for the defendant to show that there were other factors contributing to the loss. Mr. Chan failed to lead any evidence that any external factors contributed to Sino-Forest's losses.[10]

[1014] In any event, Steger did adduce evidence in reply to Ratner's critique which shows that forestry industry stock market returns worldwide, in 23 markets, generated largely positive returns during 2010 to 2014. This tends to rebut any suggestion of industrywide forces contributing to Sino-Forest's loss.

[1015] Ratner also alludes, in this context, to difficulties in the registration system for plantation ownership in China. This is another case where Ratner has trespassed into disputed issues of fact going to liability and taken what I would describe as an argumentive or advocate's point of view. The plantation registration system in China was the subject of a great deal of evidence from both fact and subject matter expert witnesses during the trial. It is the role of the Court to assess whether those problems existed and the extent to which they had an impact on Sino-Forest's BVI standing timber holdings, not the role of damages experts. To the extent there were problems with the registration system, I have found that Mr. Chan exploited those weaknesses in the commission of his fraud. They were, in that sense, a tool rather than a cause.

v) The Transaction by Transaction Approach

[1016] The question of whether Mr. Chan may only be held liable for specific amounts resulting from losses due to specific frauds, or whether Mr. Chan can only be found liable for amounts specifically traceable to him as a result of his misfeasance or breach of fiduciary duty, are legal questions, again not questions for the damages experts.

[10] This is not a case like *Livent* where there was evidence of losses unrelated to the defendants' liability for failure to discover the fraud (see, for example, paras. 308 to 326).

[1017] In my opinion, the defendant has improperly equated the need to prove a causal link between the loss and the defendant's conduct with the alleged need to prove damages on a "transaction by transaction" basis. Ratner says it should be done this way but offers no basis for this; it is merely advanced as his opinion on how a proper loss calculation should be done. Counsel for the defendant have similarly offered no legal authority for this proposition. Importantly, Ratner did not perform, try to perform, or even hint at the methodology one would use to perform the so-called "transaction by transaction" analysis, the absence of which he says so fatally flawed Steger's approach.

[1018] The defendant has not justified the transaction by transaction approach as the *sine qua non* of an appropriate loss calculation, in law or in damage calculation practice. The loss suffered as a result of Mr. Chan's fraud was more than the sum of specific losses attributable to individual transactions or components of the fraud.

[1019] It is clear that some transaction by transaction analysis has been done, for example with respect to the Greenheart and wood log trading frauds. But, as noted earlier, the BVI standing timber model was a cashless model. Even if the BVI standing timber assets were misrepresented and have no value, they were not bought with cash. No amount of "transaction by transaction" analysis will produce any loss. Does this mean that the BVI standing timber fraud caused no loss to Sino-Forest? I do not think so.

[1020] Based on fraudulent misrepresentations about the nature and value of the BVI standing timber assets, Mr. Chan caused Sino-Forest to raise money in the capital markets. When the fraud was uncovered, and the dust settled, more than half the money was gone. To the extent those funds went into the acquisition of assets, the value of those assets was realized through the EPHL sales process. What was left in cash on June 2, 2011 was largely consumed in propping up and managing the enterprise during the extended crisis brought on by the disclosure of the fraud and its ongoing investigation (including the ongoing concealment by Mr. Chan and Inside Management).

vi) No Evidence of Benefit to Mr. Chan

[1021] The defendant, through Ratner, also argues that the determination of damages for fraud requires a matching of the benefit received with the loss, which they say Steger did not do. In a similar vein, Ratner also argues that to determine the loss attributable to the defendant, a tracing must be performed of funds diverted to the alleged perpetrator. I do not accept this argument. It is simply wrong in law. The defrauding party need not have profited from his fraud to be held liable in damages: *Fiorillo v. Krispy Kreme Doughnuts Inc.*, (2009) 98 O.R. (3d) 103, at paras. 75-76; *French v. Skead*, (1877) 24 Gr. 179 (Ch.), at para. 7.

Summary of Quantum

[1022] The plaintiff has adduced evidence that connects the loss suffered by Sino-Forest to Mr. Chan's breaches on a common sense view of causation. Between 2007 and 2010, Sino-Forest raised in excess of USD$2.1 billion and CAD$800 million in Canada's debt and capital markets. This money belonged to the corporation. I find as a fact that, but for Mr. Chan's deceit, Sino-Forest would never have undertaken obligations of this magnitude to lenders and shareholders or entrusted this money to him and Inside Management. Mr. Chan, rather than directing Sino-Forest's spending on legitimate business operations, poured hundreds of millions of dollars into fictitious or over-valued lines of business where he engaged in undisclosed related-party transactions and funneled funds to entities that he secretly controlled. The loss of these funds to Sino-Forest was directly related to Mr. Chan's fraud and breach of fiduciary duty. The fact that Mr. Chan was able to conceal where a great deal of the money went after it was paid out to these non-arms' length third parties cannot defeat the plaintiff's claim. Accordingly, Mr. Chan is liable to Sino-Forest to return the property that went missing as a result of his fraud and breaches of fiduciary duty by making good the loss suffered by Sino-Forest.[11]

[1023] Mr. Chan has failed to provide any credible response to rebut the evidence that the plaintiff has adduced to link his breaches of duty to the injury suffered. Nor has Mr. Chan's expert witness been able to provide substantive responses that hold up to scrutiny against the facts as I have found them to be.

[1024] Mr. Chan refused to disclose information that would have assisted Sino-Forest to determine and mitigate its damages at an earlier stage. Mr. Chan misled Sino-Forest's Board, its auditors, and the IC, causing the company and its advisors to waste time and money investigating transactions that Mr. Chan knew were improper but which he and Inside Management concealed throughout.

[1025] The undeniable fact is that billions of dollars of forestry assets purportedly owned by Sino-Forest remain unaccounted for despite nearly six years of investigations by a number of sophisticated parties and experienced professionals, each highly motivated to find those assets. Sino-Forest spent tens of millions of dollars conducting these investigations. Mr. Chan, himself perhaps the most highly motivated of all, has also failed to come forward with any evidence confirming the validity of Sino-Forest's title to 520,000 ha of standing timber held in the BVI model or any evidence that these assets had material value.

[1026] The evidence establishes that Sino-Forest raised net cash proceeds of approximately $2.588 billion. Steger reasonably assumed that Sino-Forest would have earned a return of approximately $477.853 million had it invested that cash, using Sino-Forest's issue costs and debt interest as a proxy for a minimum rate of return. Accordingly, but for the fraud perpetrated by

[11] Although not raised by the parties, another argument might be that, but for Mr. Chan's deceit, Sino-Forest could never have raised the net amount of $2.588 billion in debt and equity in the first place. In my view, the same result obtains, however. The raising of $2.588 billion involved incurring concomitant obligations and liabilities to third parties, the bond holders and the shareholders. But for Mr. Chan's deceit, Sino-Forest would never have incurred those obligations and/or liabilities.

Mr. Chan on Sino-Forest and Mr. Chan's breaches of fiduciary duty, these funds totalling $3.065 billion would have been available to Sino-Forest to invest in legitimate business operations.

[1027] EPHL recovered $438.5 million on its sale of Sino-Forest's assets. Mr. Chan's own damages expert, Ratner, admitted that the actual price paid for a property in an arm's-length transaction is the best possible evidence of its value. As such, approximately $3,065,985,000 of Sino-Forest's monies were converted into assets ultimately worth only $438,509,000 (this includes $10 million realized from the Xunxiang arbitration). The delta, being $2,627,512,000, is Sino-Forest's loss.

Alternate Measures of Quantum

[1028] If I am wrong in this conclusion that the appropriate measure of damage is the difference between the amount raised by Sino-Forest in the capital markets and the realized value of the assets which remained, I would rely on Steger's fallback position based on the write-downs of Sino-Forest's assets, $3.2 billion.

[1029] If neither of these measures of damages were appropriate, it would be necessary to fall back on the amounts of the specific losses resulting from specific acts of fraud or breach of fiduciary duty. These proven amounts total $812.43 million, consisting of:

(1) loss from the wood log cash gap fraud ($333.2 million);

(2) loss from the wood log deposit fraud ($167.4 million);

(3) loss from the Greenheart transaction ($93.28 million);

(4) an accounting of profits (also Greenheart) ($39.65 million);

(5) the cost of Sino-Forest's investigation following the Muddy Waters report (total cost of all professional fees $137.9 million); and

(6) Mr. Chan's remuneration ($41 million).

From this total amount would have to be deducted net realization of $438,509,000, for a final compensation award of $375,923,000.

[1030] The losses incurred from the wood log cash gap fraud, the wood log deposit fraud and Sino-Forest's investment in Greenheart have been dealt with earlier in these Reasons. I will therefore briefly describe the issues relating to the disgorgement of profits, the disgorgement of Mr. Chan's remuneration and the cost of the investigation.

Accounting for Profits

[1031] As a fiduciary, Mr. Chan may be held liable to account for profits that he has obtained as a result of conduct in breach of his fiduciary duty.

[1032] The House of Lords in *Regal (Hastings) Ltd. v. Gulliver*, [1942] 1 All ER 378, held that the directors were severally liable to account to the company for profits made on the sale of shares:

> [T]he respondents were in a fiduciary position and their liability to account does not depend upon proof of *mala fides*. The general rule of equity is that no one who has duties of a fiduciary nature to perform is allowed to enter into engagements in which he has or can have a personal interest conflicting with the interest of those whom he is bound to protect.

[1033] A fiduciary's liability arises from the mere fact of a profit having been made from a breach. The profiteer, however honest and well-intentioned, cannot escape the risk of being called upon to account.

[1034] In *Canadian Aero Service Ltd. v. O'Malley*, [1974] S.C.R. 592, the Supreme Court of Canada endorsed these basic principles established in *Regal Hastings*. The Supreme Court has continued to hold that a fiduciary who breaches his or her fiduciary duty must account for and disgorge any profits received, even if the beneficiary suffered no loss; the relevant cause of action is the breach of fiduciary duty and the fiduciary's gain.

[1035] Steger calculated the profit made by Fortune and Montsford on these transactions at $37.86 million, attributing $1.792 million to the estimated cash value for GRHL shares prior to Sino-Forest's first investment.

[1036] Ratner calculated the profit (net cash received) derived by Fortune and Montsford as $31 million. The difference is that Ratner attributed $8.669 million as value for GRHL shares prior to Sino-Forest's investment. Ratner's opening value, however, ignores the fact that GRHL was effectively insolvent in 2007. Its chairman, Lei, was recommending that operations be shut down prior to Sino-Forest's bailout. It is, in my view, inappropriate to attribute a $8.67 million value to Greenheart pre-Sino-Forest investment.

[1037] In any event, even Ratner acknowledges that Fortune and Montsford collectively made a profit of at least $31 million on their shareholdings in GRHL.

[1038] I conclude that Mr. Chan earned a secret profit on personal investments made in the Greenheart Group in breach of his fiduciary duty to Sino-Forest in the amount of $37.861 million. He is therefore liable to disgorge that amount.

Repayment of Compensation and Bonuses Received

[1039] The Court has the discretion to order a fiduciary to pay back benefits received as a result of, or during the period of, his or her wrongdoing, including any bonuses payable. The circumstances of the particular case and the need to achieve the goals of restitution and deterrence govern the exercise of this discretion.

[1040] The Court also has the discretion to order a fiduciary to pay back compensation received during the period of his or her wrongdoing. The circumstances of the particular case and the need to achieve the goals of restitution and deterrence govern the exercise of this discretion as well. Members of senior management such as directors and officers are not just employees and the law will hold them to a "strict ethic" to deter their misconduct.

[1041] Ordering repayment of compensation is appropriate where the corporation would have dismissed the fiduciary for cause had the corporation known of the fiduciary's breach of duty.

[1042] As the CEO and Chairman who exercised control over corporate decision-making, Mr. Chan must be held to a strict ethic. Had Sino-Forest known about the scale of Mr. Chan's fraud, which he actively concealed from the corporation, he would have been dismissed for cause. He never would have received the $41 million that he received between 1995 and 2012. The vast majority of this amount, I should point out, was received in Mr. Chan's final years at Sino-Forest, during the most expansive phase of the BVI standing timber and wood log trading frauds. Many of the bonuses that Mr. Chan received were discretionary and Mr. Chan only acquired these bonuses because of his fraud and breaches of fiduciary duty that concealed his wrongdoing from Sino-Forest.

[1043] Therefore, I find Mr. Chan liable for $41 million, representing the compensation that he received, which he is required to disgorge. This compensates Sino-Forest by way of restitution for money that it never would have paid Mr. Chan had it known of his frauds and breaches of fiduciary duty.

The Costs of the Investigation

[1044] Mr. Chan is liable for all consequential and special damages, including the costs incurred by Sino-Forest to investigate Mr. Chan's fraud. Sino-Forest spent tens of millions of dollars investigating fictitious transactions and the explanations proffered by Mr. Chan and Inside Management to hide the manner in which he had committed fraud and breached his fiduciary duties. It does not lie in Mr. Chan's mouth to argue that Sino-Forest should not be entitled to recover the cost of investigation when Mr. Chan's non-cooperation and concealment was both the cause of and increased the cost and duration of, those same investigations. Moreover, as even Mr. Chan's own damages expert, Ratner, acknowledged in cross-examination, it was reasonable for Sino-Forest to investigate whether the allegations contained in the Muddy Waters Report were true, to keep paying regular business expenses during these investigations, to attempt to recover its assets, and to defend itself in litigation.

[1045] One of Mr. Chan's witnesses, Dickson Chau, testified that over $137 million of the cash available to Sino-Forest on June 2, 2011 was eventually spent for professional fees on investigations, the CCAA proceedings, EPHL's realizations and other matters. While this is a staggering sum, it is not surprising that a financial collapse of this magnitude and complexity would give rise to extremely high professional and related expenditures. Costs of this nature are an entirely foreseeable consequence of Mr. Chan's fraud and breach of fiduciary duty.

[1046] The gist of Mr. Chau's evidence seemed to be, however, that New Plantations, the purchaser of EPHL in 2016, may seek to challenge the amount and propriety of these payments. I find this a startling proposition. Mr. Chau, who is a forensic accountant and not a principal of New Plantations, seemed to assume, incorrectly, that New Plantations, when it acquired EPHL in 2016, acquired the right to the $898 million of cash available in Sino-Forest's accounts on June 2, 2011. To the contrary, all New Plantations acquired was the cash available in EPHL's accounts in 2016. This suggestion by Chau also ignores the fact that payment by Sino-Forest of most, if not all, of these professional fees was publicly approved by Court order in the CCAA proceedings over four years ago.

[1047] If I were wrong in my adoption of Steger's approach to damages, therefore, I would nevertheless have included in my determination of a specific transaction-based recoverable loss against Mr. Chan Sino-Forest's costs incurred in investigating Mr. Chan's fraud as well as the professional fees incurred to deal with the financial collapse and insolvency of Sino-Forest which, as I have said, resulted from and were a foreseeable consequence of Mr. Chan's fraud. The total amount, net of recoveries, for all the specific losses is, as outlined above, $373,923,000.

Punitive Damages

[1048] Punitive damages are available where there is high-handed, malicious, arbitrary or highly reprehensible misconduct that departs to a marked degree from ordinary standards of decent behaviour. Such damages are used to deter the defendant and others from similar misconduct in the future, and to mark the community's collective condemnation of what has happened. In situations of fraud and breach of fiduciary duty, punitive damages are appropriate "[w]here the actions of the fiduciary are purposefully repugnant to the beneficiary's best interests" and "the impugned activity is motivated by the fiduciary's self-interest": Mark Ellis, *Fiduciary Duties in Canada*, (Scarborough, ON: Carswell, 1993), at 20-35 – 20-36, 1980 ed. quoted by McLachlin J. (as she then was) in *Norberg v. Wynrib*, [1992] 2 S.C.R. 226, at para. 112.

[1049] In this case, Mr. Chan abused his unique position as a fiduciary to orchestrate an extremely large and complex fraud, resulting in the loss by Sino-Forest of billions of dollars. An award of punitive damages is entirely appropriate in this case. Given the sums involved, any award of punitive damages could only be token in nature. Nevertheless, in the circumstances, I award punitive damages of $5 million.

Costs

[1050] I direct counsel to confer on how best to deal with the issue of costs. They shall do so in advance of a case conference where the procedure and timetable will be resolved. Counsel shall provide my assistant a series of dates convenient to them for this case conference.

Penny J.

Released: March 14, 2018

Appendix A

List of Witnesses

Plaintiff's Witnesses

Name	Role in Litigation or at SFC
Cosimo Borrelli	Chartered Accountant, Managing Director of Borrelli Walsh Ltd., Trustee of the SFC Litigation Trust
James Dubow	Chief Executive Officer (CEO) of Emerald Plantation Holdings Ltd. (EPHL) (the corporation to which SFC's assets were transferred on 31 January 2013)
James Engen	Managing Director in the corporate finance practice at FTI Consulting Canada Inc., and the court-appointed Monitor of SFC's CCAA proceedings.
James Hyde	Member of SFC's Board of Directors and Directors' Audit Committee as of September 2004, chair of the Audit Committee as of January 2005.
Paul Brough	Former Chief Restructuring Officer (CRO) of SFC, former Chairman and Chief Executive Officer (CEO) of Emerald Plantation Holdings Limited (EPHL).
Steven Henderson	National Forensic Investigation Services Leader at PricewaterhouseCoopers LLP (PwC), a Canadian leader of the investigation into SFC from June 2011-January 2012. PwC was an advisor to the Independent Committee of Directors of SFC.
Thomas Maradin	Vice-President, Risk Management at SFC from September 2005 – June 2010, Vice-President, (Corporate) Finance at SFC from June 2010 – December 2012, consultant to SFC from December 2012 – January 2013.
Experts	
Peter Steger	Principal at Cohen Hamilton Steger & Co., Inc. retained by the Litigation Trust to perform an independent assessment of the losses suffered by SFC
Qin Tianbao	Luojia Distinguished Professor of Environment and Resources Law, Associate Dean for the School of Law, Director of the Research Institute of Environmental Law at Wuhan University, engaged to provide expert evidence on forestry law of the PRC.
Song Li	General Manager of Beijing Zhonglin Assets Appraisal Co., Ltd. Retained by the Plaintiff to provide expert evidence on practices related to ownership of standing timber in the PRC

Defendant's Witnesses

Name	Role in Litigation or at SFC
Chan Tak Yuan (also known as Allen Tak Yuan Chan)	CEO and Chairman of the Board
Hung Cham Tong (also known as Alfred C.T. Hung)	Vice President, Corporate Planning, Banking and Sales (employee of SFC since 1999)
Ho Siu Lung George (also known as Zhaolong He, may also be known as George Ho)	Chief Financial Officer and Vice-President Finance, Sino-Panel (Asia) Inc., and Vice-President Finance, SFC from October 2009 to April 2012
Lau Kok Chun (also known as James Lau)	Vice President, Business Development of Sino-Panel (Asia Inc.), formerly a subsidiary of SFC
Lei Guangyu	Part owner of Shenzhen Hongji Investment Development Company Ltd. (Hongji), as well as other companies. Owner of Fortune Universe BVI
Lim Hoe Pin	Executive Director of Greenheart Group Ltd., assisted in the acquisition of the Emerald Plantation Group Ltd. by New Plantations Ltd.
Xu Ni	SFC's Vice-President of legal affairs (employee of SFC from October 20000 to Dec 2013)
Chiang Wai Yan (also known as Yosanda Chiang)	Executive Secretary of Allen Mr. Chan since 2003
Zeng Haibin (also known as John Zeng)	Lawyer whose firm, Kai Tong, acted occasionally for SFC subsidiaries in the PRC. Also acted for Mr. Chan personally. Owner of the Montsford BVI
William Ardell	A director of the independent committee appointed by SFC's board; member of the Special Restructuring Committee of SFC's Board
Experts	
Glass Ratner Advisory & Capital Group LLC	Experts retained on behalf of Mr. Chan to provide independent forensic accounting and loss quantification expertise
Chau Tat Sun (also known as Dickson Chau)	Investigator for EGPL
Randall Peerenboom	Lawyer and professor retained to give evidence on forms of investment and business practices in the PRC
Wang Jin	Law professor at Peking University, engaged to provide expert evidence on

	PRC law as it relates to forestry practices
Xiao Dong Hao (also known as Gavin Hao)	Forestry consultant, RISI, with expertise in PRC forestry management and development

CITATION: Borrelli v. Chan, 2018 ONSC 1429
COURT FILE NO.: CV-14-10684-00CL
DATE: 20180314

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

COSIMO BORRELLI, in his capacity as trustee of the SFC LITIGATION TRUST

Plaintiff

– and –

ALLEN TAK YUEN CHAN

Defendant

REASONS FOR JUDGMENT

Penny J.

Released: March 14, 2018

COURT OF APPEAL FOR ONTARIO

CITATION: SFC Litigation Trust v. Chan, 2019 ONCA 525
DATE: 20190624
DOCKET: C65247

2019 ONCA 525 (CanLII)

Hoy A.C.J.O., Brown and Zarnett JJ.A.

BETWEEN

Cosimo Borrelli, in his capacity as trustee of the SFC Litigation Trust

Plaintiff (Respondent)

and

Allen Tak Yuen Chan

Defendant (Appellant)

Robert Rueter, Sara J. Erskine, and Malik Martin for the appellant

Robert W. Staley, Jonathan G. Bell, William A. Bortolin, Jason M. Berall and Preet Bell, for the respondent

Heard: January 14 and 15, 2019

On appeal from the judgment of Justice Michael A. Penny of the Superior Court of Justice, dated March 14, 2018, with reasons reported at 2018 ONSC 1429.

Zarnett J.A.:

I. Introduction

[1] The appellant, Allen Tak Yuen Chan, was the co-founder, chief executive officer and chairman of the Board of Directors of Sino-Forest Corporation

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(“SFC”), a corporation which had its head office in Ontario and whose shares traded on the Toronto Stock Exchange.

[2] SFC’s subsidiaries carried on an integrated forest plantation and products business with assets located predominately in the People’s Republic of China (“PRC”).

[3] Between 2003 and the second quarter of 2011, SFC’s consolidated financial statements reported rapid growth, including in assets and revenues. A significant portion of the reported assets in the second quarter of 2011 – some $2.99[1] billion – was “BVI standing timber “, that, is standing timber held under what was known as the “BVI model”. Sales of BVI standing timber accounted for $1.3 billion of SFC’s reported consolidated revenue in 2010, and over 90% of its reported consolidated income.

[4] Representing BVI standing timber as an asset with significant value on the SFC financial statements enabled SFC to raise money in the debt and equity markets – approximately $3 billion up to 2010.

[5] In June 2011, a report was issued by a short seller’s research company (the Muddy Waters Report) which was, to say the least, highly critical of SFC. It alleged, among other things, that SFC did not hold anything close to the full

[1] All references to currency are in USD, unless otherwise noted.

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amount of the timber assets reported on its financial statements and that it greatly overstated its revenues. SFC formed an Independent Committee to investigate. It was unable to rebut the allegations or confirm ownership of the BVI standing timber. SFC could not issue further financial statements and advised the public, following discussions with its external auditors, that prior years' financial statements should not be relied upon. The Ontario Securities Commission ("OSC") ordered that trading in SFC securities cease. SFC defaulted on its debt obligations. A number of class actions were commenced against SFC and its directors, auditors, underwriters and consultants.

[6] On March 30, 2012, SFC obtained insolvency protection under the *Companies' Creditors Arrangement Act,* R.S.C. 1985, c. C-36 *("CCAA").* On December 10, 2012, the Superior Court sanctioned SFC's CCAA Plan of Compromise and Reorganization (the "Plan"). Under the Plan, SFC's interests in its subsidiaries were transferred to holding companies owned by SFC's creditors and its causes of action were transferred to the SFC Litigation Trust (the "Litigation Trust") constituted for the benefit of its creditors. In exchange, SFC's creditors released their claims for repayment of debts owed to them by the company.

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[7] In 2014, the respondent, as trustee of the Litigation Trust, commenced this action alleging that the appellant had committed fraud against, and breached his fiduciary duty to, SFC.

[8] After a 48-day trial, the trial judge found that the appellant had directed a “massive fraud” in breach of his fiduciary duties to SFC, causing SFC to misrepresent its assets and their value. This enabled SFC to raise significant funds in the capital markets. SFC would not have undertaken obligations of this magnitude to lenders or shareholders, or entrusted the funds raised to the appellant and his management team, but for the appellant’s fraud. The trial judge found that the appellant’s conduct caused a loss to SFC. The funds raised were either directed by the appellant into fictitious or over-valued lines of business which dealt with third parties secretly related to and entities secretly controlled by the appellant, or were largely consumed by the necessity of dealing with the consequences of the discovery of the appellant’s fraud and the collapse of SFC that followed. The trial judge awarded damages equal to what he found to be SFC’s loss – $2,627,478.00 – as well as punitive damages of $5 million Canadian.

[9] The appellant asks us to reverse the trial judgment, making the following principal arguments:

a) The respondent is only entitled to advance claims that were transferred to the Litigation Trust under the Plan. Properly interpreted, the Plan did not transfer the claims advanced in this action to the Litigation Trust.

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b) The trial judge’s award of damages is flawed because he did not conduct a proper causation analysis and awarded compensation for losses not of SFC, but of its stakeholders (its noteholders and shareholders). In doing so he improperly exposed the appellant to duplicate claims and created risks of double recovery.

c) The respondent’s claim ought to have been rejected under the doctrine of election. When SFC transferred the assets, contracts and businesses of its subsidiaries as contemplated by the Plan (by transferring its subsidiaries’ shares), there was an election to treat them as valid. Yet the respondent’s claim is premised on those same assets, contracts and businesses being fraudulent and invalid.

d) The trial judge made various errors in his acceptance of evidence, including evidence based on documents that had not been translated into English and on opinions from a non-expert, which make his factual conclusions unsafe to rely upon.

[10] For the reasons which follow I would dismiss the appeal. As I explain below:

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a) The trial judge did not err in his conclusion that the claims advanced in the action were causes of action that had been held by SFC, had been transferred to the Litigation Trust by SFC under the Plan, and could be pursued by the respondent against the appellant.

b) The trial judge did not err in his causation analysis or assessment of damages. His determinations in that regard were not the product of legal errors and there is no basis to interfere with his factual determinations, which are subject to deference from this court.

c) There is no merit to the argument that the transfer of the shares of SFC's subsidiaries pursuant to the Plan was an election that barred the respondent from suing for damages arising from the appellant's conduct.

d) The complaints of the appellant about the trial judge's approach to certain evidence do not justify any interference with the judgment the trial judge reached. The trial judge assiduously reviewed the evidence given in a lengthy trial and his factual conclusions were supported by the record.

II. The Facts and the Trial Judge's Award

[11] In addition to the facts outlined above, the following facts are important to appreciation of the issues on the appeal. I set them out based on the trial judge's findings, since on the first three issues that the appellant raises, he contends the

trial judgment cannot stand even on those findings. I then deal separately, as the parties did, with the appellant's complaints about the trial judge's fact-finding.

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(1) *The Appellant's Role and the Nature of the Wrongdoing*

[12] The trial judge found that the appellant had ultimate control over nearly all aspects of SFC's and its subsidiaries' operations, directly and through a small group of individuals he directed on his management team (the trial judge referred to them collectively as "Inside Management").

[13] The trial judge identified four different, but related, frauds for which the appellant was responsible and one other transaction in which there was a breach by the appellant of his fiduciary duties. I summarize these below.

(a) The BVI Model Fraud

[14] The most significant fraud found by the trial judge had to do with the reporting, on SFC's consolidated financial statements, of assets held and revenue and income generated under the BVI model.

[15] The BVI model involved SFC subsidiaries incorporated in the British Virgin Islands ("BVIs"). It was designed in light of restrictions at one time imposed by the PRC under which foreign entities were not permitted to have PRC bank accounts, operate or sell timber plantations, or own land use rights in the PRC.

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[16] To circumvent these restrictions, the BVI Model contemplated that SFC's BVI subsidiaries would acquire standing timber from third parties known as "Suppliers", who in turn would acquire it from others, typically rural or business collectives. The BVIs would sell standing timber indirectly, through authorized intermediaries ("AIs") that acted as their customers. The BVIs would not pay the Suppliers or receive payment from the AIs. Instead, the AIs and Suppliers would be directed to set off payments so that payment from an AI for the sale of standing timber rights would be rolled forward into the purchase of new BVI standing timber rights from a Supplier. Consequently, no cash would flow through the BVIs' or SFC's bank accounts in connection with the BVI standing timber and money associated with the BVI standing timber would be locked up in the PRC to be rolled forward into further BVI standing timber purchases.

[17] Under the BVI model, the BVIs would not acquire actual land use rights in the PRC. Instead, they ostensibly would acquire a contractual right to the standing timber itself.

[18] As noted above, significant valuable assets were reported by SFC as held, and revenue and profit-generating activity was reported as occurring, under the BVI Model. By the second quarter of 2011, SFC's consolidated financial statements showed BVI standing timber assets valued at $2.99 billion. Trading

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under that model was the biggest contributor to the revenues and profits shown on the statements.

[19] After the Muddy Waters Report, the Independent Committee was, however, unable to locate key documents to confirm valid title to the BVI standing timber or to even determine its location. Collections of accounts receivable from AI's, which had been represented to take place with 100% success, dropped to close to 0%. Consultants retained by SFC's creditors were also unable to locate or verify the BVI standing timber assets. When the Monitor for SFC appointed under the *CCAA* made unannounced site visits to Suppliers and AIs at their registered addresses, it found, with only one exception, little to no evidence of any operations. Those entities were later established to have undisclosed connections to the appellant and his management team.

[20] The inability to locate or verify the BVI standing timber assets continued after the Plan was sanctioned by the Superior Court. Under the Plan, the rights to any such assets were transferred to entities owned by former SFC creditors; they were subsequently sold to a third party purchaser, New Plantations. The transferees had strong economic motivations to locate the standing timber assets. None of the transferees could do so.

[21] The trial judge considered, among other things, expert and other evidence about the type of documents that would be required to validly show title to the

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reported BVI standing timber assets and evidence of the efforts taken to locate and establish ownership or valid title to the standing timber assets that had been represented on the SFC consolidated financial statements as having a value of $2.99 billion. He found that:

a) Proper documentation to establish valid title to the assets did not exist. For example, maps, essential to establish the locations of the alleged standing timber assets, were produced by the appellant and his management team for only 1% of the claimed assets.

b) Despite efforts by persons with significant motivation to locate those assets so they could be monetized, they had not been located even up to the time of trial in 2017.

[22] The trial judge concluded that the BVI standing timber model was a fraud perpetrated by the appellant, that the assets reported simply did not exist, and that the transactions reported as resulting in revenue and income were paper transactions without substance. He stated:

> [551] The former assets of [SFC] have now been in the hands of New Plantations for more than a year. Even with Mr. Chan’s assistance, New Plantations has not produced any evidence that it has been able to find, prove title to or monetize any purported interest in the BVI standing timber assets. It has not paid anything to EPHL [the former-creditor-owned company] under the RAPA arising out of the sale of any BVI assets. The best [the appellant] can offer in this regard is revealed in

the evidence of Alvin Lim, who testified that New Plantations is “still in the process of investigation.”

[552] Six years have passed since the Muddy Waters Report was released and nobody, despite enormous financial incentives to do so, (incentives motivating [SFC], the bondholders, the purchaser Emerald [the former-creditor-owned company], the purchaser New Plantations and [the appellant] himself), has been able to locate, confirm ownership of, or monetize the BVI assets. When considered in the context of all the evidence, the inescapable conclusion is that [SFC] did not own the BVI assets that it claimed to own.

[553] All of the evidence considered as a whole, leads to the inescapable conclusion that the BVI standing timber model was a fraud. The logical and reasonable inferences to be drawn from the totality of the evidence, based on a preponderance of probabilities, are that:

> i) the defendant and others inside and outside [SFC] management operated an elaborate system of nominee companies ultimately controlled by [the appellant] or persons acting under his direction;
>
> ii) many of these nominees companies were major Suppliers of BVI standing timber;
>
> iii) the Suppliers and AIs were not *bona fide* arm’s length sellers and purchasers of BVI standing timber;
>
> iv) the BVI standing timber transactions were paper transactions. [SFC] employees under the direction of [the appellant] and his cadre of Inside Management created the contracts, the supporting documents and the so-called evidence of directed payments made between the AIs and Suppliers. No consideration in fact passed between these entities;

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> v) [SFC] subsidiaries did not hold title to BVI standing timber plantations;
>
> vi) the value of [SFC's] BVI standing timber, represented at $2.99 billion in 2011, did not exist. Because [SFC] did not own these assets, this value was nil; and
>
> vii) the defendant and members of Inside Management exploited weaknesses and ambiguities in the PRC forestry regulatory regime to perpetrate this fraud and to conceal it from scrutiny by [SFC], external auditors, other professional advisors, independent members of the Board and the public.

(b) The WFOE Standing Timber Fraud

[23] A second fraud found by the trial judge arose within a method of doing business referred to as the WFOE standing timber model. That model was used because in 2004 the PRC gave permission for foreign investors to invest in PRC-incorporated trading companies, known as wholly foreign owned enterprises ("WFOEs"), which could acquire actual plantation land use rights, harvest timber, sell logs and standing timber directly to end users, and open PRC bank accounts. WFOEs were also permitted to plant standing timber plantations due to their land use rights.

[24] Assets were acquired and activities undertaken by SFC subsidiaries which were WFOEs. These included planting forests and holding them until harvest

(“planted plantations”) and, in addition, ostensibly acquiring and trading in existing standing timber (“purchased plantations”).

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[25] The trial judge found that the hallmarks of the BVI standing timber fraud were present in the purchased plantations aspect of the WFOE standing timber model. Many of the WFOE purchased plantation transactions were conducted through Suppliers controlled by the appellant and his management team. Plantation rights certificates were lacking for most of the purchased plantations. The trial judge concluded that “like the BVI standing timber, the majority of the WFOE purchased plantations were never actually owned by [SFC] and had no value”: at para. 562.

(c) The Wood Log Trading Cash Gap Fraud

[26] The third fraud found by the trial judge was in wood log trading activities. From 2005 to 2010, revenue from wood log trading ranged from 15% to 25% of SFC’s total consolidated revenues, and a smaller percentage of SFC’s consolidated profits. Under SFC’s wood log trading model, an SFC BVI subsidiary would purchase logs from a Supplier outside of the PRC and pay for the logs using a letter of credit guaranteed by SFC. It would then resell the logs to a customer. However, typically only about 70% of the wood log sales accounts receivable were paid in cash by the customer. The remaining 30% was directed

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to BVI standing timber Suppliers, which had the effect of diverting “new” money into the BVI standing timber model.

[27] The diversion of 30% of the wood-log-trading receivables to BVI standing timber Suppliers, for assets the trial judge determined did not really exist, created a “cash gap” – $239.8 million more was paid out to purchase wood logs than was received on their sale. And, after the Muddy Waters Report, substantial amounts of accounts receivable associated with the wood log trading business were not paid – the customers vanished. Many of SFC’s wood log customers were found not to have been at arm’s-length from the appellant.

[28] The trial judge found “the preponderance of probabilities, having regard to all of the evidence, is that the wood log cash gap was a fraud orchestrated by [the appellant] with the assistance of [his management team] at [the appellant’s] direction”: at para. 633.

(d) The Wood Log Deposit Fraud

[29] The fourth fraud found by the trial judge arose from the practice of placing deposits for the purchase of the logs. The appellant caused SFC subsidiaries to enter into wood log trading agreements requiring payment of substantial unsecured “deposits” and “advance payments” for the purchase of logs, which exceeded the value of any logs actually delivered. After the Muddy Waters Report, log deliveries ceased and, with one exception, none of the deposits or

advance payments were repaid, resulting in a loss of $167.4 million. The appellant’s relationship with many of the wood log suppliers was not at arm’s-length.

[30] The trial judge found the preponderance of evidence established that the wood log deposit transactions were a fraudulent mechanism for diversion of funds out of SFC to entities controlled by the appellant or acting under his direction.

(e) The Greenheart Transaction

[31] The further transaction in which the trial judge found a breach of fiduciary duty by the appellant was referred to as the Greenheart Transaction. Between July 2007 and July 2010, the appellant caused SFC to acquire a majority interest in Greenheart Resources Holdings Limited and its majority shareholder, Greenheart Group Limited (collectively, “Greenheart”), by purchasing shares from shareholders of Greenheart, including several in which the appellant had undisclosed interests. At the time of the acquisitions, the appellant knew but did not disclose that Greenheart was in serious financial difficulties. SFC ultimately invested $202.2 million, which was more than the amount realized when the Greenheart interest was later sold.

[32] The trial judge found that the appellant had committed a clear violation of his fiduciary duties through his nondisclosure. In addition to causing a loss to SFC,

he made an undisclosed personal profit of approximately $38 million on the transaction.

(2) *The Collapse of SFC, The Fate of the Funds Raised, The CCAA Process and Realizations on Assets*

[33] The events following the Muddy Waters Report and the inability of SFC to rebut its allegations had a profound impact on the company.

[34] In August 2011, the OSC issued a cease-trading order over SFC's securities, alleging that SFC had engaged in significant non-arm's-length transactions, its assets and revenues had been exaggerated, and that the appellant and others appeared to be involved in the fraud.

[35] SFC became unable to issue further financial statements. In December 2011, it advised it could give no assurance it would ever be able to do so. In January 2012, SFC issued a press release which stated that its "historic financial statements and related audit reports should not be relied upon".

[36] By early 2012 SFC, the appellant, and others had been named in at least four class actions alleging that SFC's financial statements were materially false and misleading and claiming, on behalf of classes of debt and equity holders, damages for amounts that they overpaid when they purchased securities in reliance on the false financial statements, among other relief.

[37] SFC defaulted on its debt obligations. In March of 2012, it entered into a Restructuring Support Agreement with its noteholders, who held first priority security interests over the shares of SFC's subsidiaries, which contemplated the transfer of SFC's business to those noteholders unless a sales process revealed that the value of SFC's assets exceeded its debt. The sales process revealed that potential purchasers were only willing to pay a fraction of the quantum of the debt for the company's assets. Consequently, the sales process terminated in June 2012.

[38] SFC filed for insolvency protection under the *CCAA* on March 30, 2012, and the Superior Court sanctioned its Plan on December 10, 2012. Under the Plan, SFC's assets were transferred to creditor-controlled entities and SFC's causes of action were transferred to the Litigation Trust. The Plan provided for releases of SFC and specified others. The precise terms of the Plan bearing on the issues in this appeal are more fully described in the Analysis section below.

[39] The trial judge found that by the time the fraud was uncovered and "the dust settled", more than half of the almost $3 billion that had been raised by SFC on the capital markets was gone. He also found that what was left in cash by June of 2011 was largely consumed in propping up and managing the enterprise during the extended crisis brought on by the disclosure of the fraud and its investigation (including dealing with ongoing concealment by the appellant and

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his management team). He found that, to the extent that the funds raised on the capital markets had actually been invested in assets, the value of those assets was represented by the amounts realized on their sales, effected under and after implementation of the Plan.

[40] Under the Plan, effective January 30, 2013, all of SFC's assets, including its interests in wholly-owned subsidiaries, were transferred to Emerald Plantation Holdings Limited ("EPHL") and then by EPHL to Emerald Plantation Group Limited ("EPGL"), a wholly-owned subsidiary of EPHL. These entities were formed for the purpose of holding SFC's assets and realizing on them to achieve recoveries for SFC's creditors, who became EPHL's shareholders.

[41] Commencing in October 2014, EPGL caused the sale of the Greenheart business and then of miscellaneous assets to third parties. In 2016, EPGL caused the sale of the remaining assets to New Plantations, a third-party purchaser. The sale to New Plantations had special provisions for further payments if New Plantations was able to make any recovery on assets that were ascribed zero value in the sale, including the BVI standing timber, the BVI standing timber receivables, the wood log receivables, and the wood log deposits. The trial judge found that, at the time of trial, there had been no recoveries on, or any further payments in respect of, those assets: at paras 89 to 96.

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[42] The total net recoveries from the sale of assets of SFC's subsidiaries was $438.5 million.

(3) *The Trial Judge's Damages Award*

(a) Causation

[43] The trial judge approached causation on the basis that the "but for" causation test was to be applied in a common sense, robust fashion; that causation could be inferred from evidence that connected the wrongdoing to the injury; and that inferences could be drawn against a defendant found liable for fraud or breach of fiduciary duty who did not provide credible alternative causes for the loss.

[44] The trial judge's factual findings about causation can be summarized as follows. Between 2004 and 2010, SFC raised in excess of $2.9 billion in Canada's debt and equity markets, based on the appellant's fraudulent misrepresentations of the existence and value of assets. But for the appellant's deceit, SFC would never have undertaken obligations of this magnitude to lenders and shareholders, nor would it have entrusted the money it raised to the appellant and his management team. The appellant directed much of the money raised towards fictitious or over-valued lines of business, engaged in undisclosed related-party transactions and funneled funds into entities he secretly controlled. This conduct, and the consequences of its discovery, ultimately caused the

collapse of SFC. The trial judge found that SFC had suffered losses directly related to the appellant’s fraud and breach of fiduciary duty.

(b) Measurement of Damages

[45] The trial judge referred to the measure of tort damages for deceit and to the principles of equitable compensation. He accepted that the proper approach to measuring SFC’s loss was the primary approach put forward by the respondent’s expert, Peter Steger.

[46] Steger’s primary approach began with the $2.9 billion SFC raised in the debt and equity markets between 2004 and 2010. Subtracting the share and debt issue costs and principal debt repayments made by SFC, he calculated the net cash available to SFC from these capital raises as $2.588 billion. To this, Steger added a proxy for the minimum return that SFC should have made by investing the cash. This led to an available cash figure of $3.065 billion.

[47] On the basis that SFC would have had $3.065 billion in cash available for investment in profit-generating assets, Steger considered the effect of the appellant’s conduct, which saw those funds invested in subsidiaries engaged in largely fraudulent businesses. To the extent there was value in the businesses that were invested in, it was represented by the $438.5 million amount that was actually recovered by EPGL from the sales of the assets acquired from SFC

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under the Plan. The difference between these two figures – $2.627 billion – represented SFC’s loss attributable to appellant’s conduct.

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[48] The trial judge rejected the appellant’s argument that damages could only be calculated on a “transaction by transaction“ basis, both as a matter of law and because the appellant’s damages expert, who criticized Steger for not conducting that analysis, did not do it himself or “hint at a methodology” to do so.

[49] The trial judge considered two other damages calculations, in case Steger’s primary approach was found to be incorrect. The first was an alternative approach set out by Steger, which calculated damages of $3.2 billion based on a write-down of assets methodology. He then considered a specific loss approach, based on calculating the losses resulting from specific proven acts of fraud or breach of fiduciary duty, including the wood log cash gap fraud, the wood log deposit fraud, the Greenheart transaction, the appellant’s profits on the Greenheart transaction, the cost of SFC’s investigation following the Muddy Waters Report, and the appellant’s remuneration. These amounts totalled $812.43 million. Deducting the net realization of $438.5 million from post-Plan sales produced an alternative specific loss compensation award of $373.9 million. However, the trial judge concluded that the primary Steger approach, rather than either of these other approaches, should be accepted.

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[50] The trial judge awarded punitive damages of $5 million Canadian on the basis of his finding that the appellant had abused his fiduciary position to orchestrate a large and complex fraud, resulting in billions of dollars of losses.

(4) ***The Trial Judge's Rejection of Specific Defences***

(a) Duplication with Class Actions

[51] The trial judge rejected the argument that the respondent could not recover any amounts because there was duplication between the claims made in this action and claims made in certain class actions (the "Class Actions", as defined in the Plan) that had named both SFC and the appellant, among others, as defendants. He noted that the Class Actions alleged some of the same facts as were alleged in this action and that those Class Actions had been brought on behalf of persons who acquired SFC securities (defined as common shares, notes and other securities) from 2007 to 2011.

[52] The trial judge held that the claims advanced in this action were transferred to the Litigation Trust and properly advanced by the respondent because they were claims against the appellant that, prior to their transfer, could have been asserted by SFC; were not released by the Plan (under which the appellant received no release); and were not "Excluded Litigation Trust Claims" as defined in the Plan, which were not transferred to the Litigation Trust. He noted the Plan's language that claims advanced in the Class Actions were not transferred to the

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Litigation Trust, but held that the claims in the Class Actions were different than those in this action. The claims in the Class Actions were not for wrongs done to SFC but were claims for wrongs done to individual noteholders or shareholders; thus they were different causes of action held by different persons. Nor was there a risk of double recovery. The courts in the Class Actions could prevent that from occurring when those actions reached judgment (the Class Actions were still at the pleadings stage).

(b) No Affirmation

[53] The trial judge also rejected the argument that SFC had elected to affirm the validity of all of the assets, contracts, and transactions that the respondent complained of when it transferred the shares of its subsidiaries to EPGL under the Plan, such that the respondent could not sue and recover damages for them on the basis that they were fraudulent. He found the principle of affirmation had no application to the case.

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III. Analysis

(1) *Is the Respondent Precluded By The Plan from Advancing The Claims in This Action?*

(a) Introduction

[54] The appellant makes three arguments that the Plan did not transfer, to the Litigation Trust, the causes of action that are asserted against him by the respondent and that therefore the Plan precludes those claims from being advanced: (1) the claims are the same as, or overlap with, the claims asserted in the "Class Actions" which were not transferred to the Litigation Trust; (2) the claims constitute "Excluded Litigation Trust Claims" which were excepted from the transfer of claims to the Litigation Trust; and (3) the claims constitute "SFC Intercompany Claims" that were assigned under the Plan by SFC to EPGL and not to the Litigation Trust. (Each of the quoted terms is a defined term in the Plan).

[55] The appellant's argument that the claims advanced in this action were not transferred to the Litigation Trust is an argument about the meaning of the Plan. It was common ground before the trial judge and in this court that the respondent's ability to bring these claims had to derive from the provisions of the Plan, the Litigation Trust Agreement made thereunder and the terms of the Sanction Order which approved the Plan. These defined what causes of action

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were transferred to the Litigation Trust and which were not. It was not suggested that the terms or effect of these three documents differed on the issues material here, and accordingly argument was chiefly directed to the terms of the Plan itself.

[56] I first address the principles of interpretation to be applied to the Plan and the standard of review to be applied by this court in assessing the interpretation arrived at by the trial judge. I then address the factors bearing on the interpretation of the Plan and the precise terms of the Plan. Finally I consider whether the appellant's arguments disclose any reversible errors in the trial judge's interpretation of the Plan.

(b) The principles of interpretation

[57] A *CCAA* plan of compromise and arrangement has been held to be "in substance a contract, sanctioned by the Court", to be interpreted in light of the purposes of the *CCAA*, the overall purpose and intention of the plan in question, and the principles of contractual interpretation: *Re Canadian Red Cross Society* (2002), 35 C.B.R. (4th) 43 (Ont. S.C.), at paras. 12 to 13; aff'd 46 C.B.R. (4th) 239 (Ont. C.A.), leave to appeal refused, [2003] S.C.C.A. No. 539; see also *The Catalyst Capital Group Inc. v. VimpleCom Ltd.*, 2018 ONSC 2471, at para. 109, aff'd on other grounds, 2019 ONCA 354, applying these principles to a corporate plan of arrangement.

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[58] The principles of contractual interpretation include: reading the words of the document as a whole, giving meaning to all its terms; determining the parties' intentions in accordance with the words used; considering the factual matrix (the objective facts known at the time of contracting) to aid in understanding the words used; and adopting an interpretation which avoids commercial absurdity: *Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust,* 2007 ONCA 205, 85 O.R. (3d) 254, at para. 24; *Sattva Capital Corp. v. Creston Molly Corp.*, 2014 SCC 53, [2014] 2 SCR 633, at paras. 47-48, 57-58.

(c) The standard of review

[59] This court has given deference to the interpretation of a plan by a judge who had familiarity with the plan's development through supervision of the debtor's restructuring: *Red Cross* (Ont. C.A.), at para. 2. The respondent argues that the same approach of deference should apply here as the trial judge, an experienced Commercial List judge, had the opportunity to consider the Plan in light of its purpose, terms and the factual matrix explored in a lengthy trial. This deferential approach would be consistent with viewing the Plan as "in substance a contract": *Red Cross* (Ont. S.C.), at para. 13. A trial judge's contractual interpretation is, absent extricable legal error, generally subject to appellate deference: *Sattva,* at paras. 52-55.

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[60] The appellant asks this court to replace the trial judge's interpretation of the Plan with its own, arguing that a correctness standard should apply. A correctness standard of appellate review applies to contractual interpretation where consistency of meaning is a primary concern and where there is no meaningful factual matrix to consider. Certain standard form contracts of adhesion are examples: *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37, [2016] 2 S.C.R. 23.

[61] Although a *CCAA* plan is not a standard form contract, plans often use language borrowed from other plans, giving rise to consistency concerns. Moreover, a plan is different from an ordinary contract in that it takes its force not only from the consent of parties who have been involved in its negotiation, but also from the provisions of the *CCAA* which render a plan binding on those who have not agreed to or voted for it, if the requisite majorities of creditors have done so and court approval has been obtained: *CCAA*, s. 6(1). In this respect a plan has aspects of a contract of adhesion.

[62] Nonetheless, in my view a deferential standard of review should apply. *CCAA* plans are developed to fit the unique circumstances of each restructuring. The overall purpose and intention of the individual plan are important determinants of its interpretation, to be considered against the backdrop of the factual aspects of the restructuring and the events that led up to it. The types of

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considerations that will go into a plan's interpretation will usually be fact and context-specific and the factual matrix will accordingly be important. The questions which arise in the interpretation of a plan will almost always be mixed questions of law and fact. All of this supports a deferential standard of appellate review, one that accords with the standard applicable generally to a trial judge's interpretation of a contract.

[63] Accordingly, absent an extricable error of law, an interpretation that involves palpable and overriding errors of fact, or one that is clearly unreasonable, the trial judge's interpretation should not be interfered with.

(d) The Factual Matrix

[64] The trial judge did not expressly identify which facts he considered to be the factual matrix relevant to the Plan's interpretation. But he did make significant findings about how and why the Plan came about. It is the "facts giving rise to the plan" that are important to determine its scope and meaning: *Catalyst,* at para 110. Here, those facts include: that SFC had been forced to file for *CCAA* protection because of the fraud and the consequences of its discovery; the appellant had been identified, including by the OSC, as allegedly having been involved in that fraud; it had already been determined that the assets SFC offered in the sales process were worth substantially less than the amount of its debt so that additional sources of recovery by SFC, including recoveries through

litigation, would be important; and class actions by SFC stakeholders were already pending against the appellant, amongst others, in which SFC stakeholders, but not SFC itself, were advancing claims.

(e) The Purposes of the CCAA and of the Plan

[65] The full title of the *CCAA* states that it is: “An Act to facilitate compromises and arrangements between companies and their creditors.” “The *CCAA* has the simultaneous objectives of maximizing creditor recovery, preservation of going-concern value where possible, preservation of jobs and communities affected by the firm’s financial distress, rehabilitation of honest but unfortunate debtors, and enhancement of the credit system generally.” (emphasis added): Janis P. Sarra, *Rescue!: The Companies Creditors Arrangement Act*, 2nd ed. (Toronto: Carswell, 2013), at p. 14.

[66] Creditors are a key constituency under the *CCAA*, as the approval of specified majorities of creditors is required for a plan of compromise and arrangement to be effective: *CCAA*, s. 6(1). Given the objectives of the *CCAA* and the need for creditor approval, it is reasonable to expect that the goal of a plan will be to maximize the value to be obtained from the insolvent corporation’s assets, including its intangible rights such as litigation claims, so as to enhance ultimate distributions to creditors. A key barometer of a plan’s acceptability is how

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it proposes to achieve that goal compared to what would be available through alternative insolvency processes, such as liquidation or bankruptcy.

[67] The SFC Plan addressed those objectives. It provided in section 2.1 that it was “put forward with the expectation that the Persons with an economic interest in SFC … will derive greater benefit from the implementation of the Plan and the continuation of the SFC Business as a going concern than would result from a bankruptcy or liquidation of SFC.”

[68] And in keeping with this expectation, the Plan described its purpose: to release SFC from the claims of “Affected Creditors”[2]; to transfer ownership of the business of SFC to creditor-controlled entities free and clear of all claims against SFC and its subsidiaries, so as to enable the business to continue on a going-concern basis; and “to allow Affected Creditors and Noteholder Class Action Claimants[3] to benefit from contingent value that may be derived from litigation claims to be advanced by the Litigation Trustee”: section 2.1.

[2] Affected Creditors were defined by the Plan as including persons with Noteholder Claims. A Noteholder Claim included a claim for principal and accrued interest under Notes (debt instruments issued by SFC when it raised financing on the public markets) by the owner or holder of such Note or their trustee.

[3] Noteholder Class Action Claimants were persons with Noteholder Class Action Claims. These were defined as claims as Noteholders in class actions against SFC and its directors, officers, auditors or underwriters, relating to the purchase, sale or ownership of the Notes, but did not include Noteholder Claims, i.e., did not include claims for principal and accrued interest payable under the Note.

[69] The Superior Court sanctioned the Plan, finding this purpose and its implementation in the Plan to be in compliance with the *CCAA* and its objectives: *Re Sino-Forest Corporation,* 2012 ONSC 7050, at para. 79.

(f) The Plan's Operative Terms

[70] The Plan provided two avenues for assets of SFC to be realized upon and the proceeds distributed to creditors: (1) by the transfer of SFC causes of action to the Litigation Trust; and (2) by the transfer of the shares of SFC's subsidiaries to creditor controlled entities, EPHL and EPGL: section 6.4(h). The provisions of the Plan implementing these transfers, as well as the release provisions of the Plan, are key to assessing the appellant's arguments.

[71] The Plan provided, in section 6.4(o), that SFC would establish the Litigation Trust. SFC and the trustees for SFC's noteholders would then convey to it the "Litigation Trust Claims", defined by the Plan as:

> [A]ny Causes of Action that have been or may be asserted by or on behalf of: (a) SFC against any and all third parties; or (b) the Trustees (on behalf of the Noteholders) against any and all Persons in connection with the Notes issued by SFC; provided, however, that in no event shall the Litigation Trust Claims include any (i) claim, right or cause of action against any Person that is released pursuant to Article 7 hereof or (ii) any Excluded Litigation Trust Claim. For greater certainty: (x) the claims being advanced or that are subsequently advanced in the Class Actions are not being transferred to the Litigation Trust; and (y) the claims transferred to

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> the Litigation Trust shall not be advanced in the Class Actions."

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[72] "Causes of Action", used in the definition of Litigation Trust Claims, was given a very broad meaning, which included any claims or entitlements in law, equity or otherwise for damages or other relief.

[73] However, the definition of "Litigation Trust Claims" narrowed the transfer of claims to the Litigation Trust (i) by excepting claims against certain individuals and entities who were released by the Plan and (ii) by excepting "Excluded Litigation Trust Claims" from the claims that would otherwise have been transferred to the Litigation Trust: Article 7. "Excluded Litigation Trust Claims" were defined as Causes of Action agreed, as between SFC and a subgroup of Noteholders, to be excluded from the Litigation Trust Claims: section 4.12. Section 4.12(b) of the Plan specified that certain claims against SFC's Underwriters fell within this category, except if they were claims for fraud or criminal conduct.

[74] The definition of "Litigation Trust Claims" contained "greater certainty" language specifying that claims in the "Class Actions" were not transferred to the Litigation Trust. The "Class Actions" referred to in the "greater certainty" clause were defined to mean four specific actions in Ontario, Quebec, Saskatchewan and New York, brought on behalf of persons who, during defined class periods, had purchased SFC notes or shares. The Class Actions include: claims against

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the appellant based on allegations that he made false representations that SFC's financial statements were accurate when they in fact were materially misleading and grossly overstated SFC's assets; that the appellant's misrepresentations induced class members to buy equity or debt at inflated prices; and that he thus caused them losses. The plaintiff classes seek damages, among other things, to recover the amounts they paid or overpaid to acquire those securities.

[75] Section 4.11 of the Plan set out who would benefit from any recoveries on claims transferred to the Litigation Trust. Beneficial interests in the Litigation Trust were to be held 75% by Affected Creditors[4] and 25% by Noteholder Class Action Claimants[5].

[76] In addition to their interests in the Litigation Trust, Affected Creditors also received interests in EPHL, a holding company which held the shares of EPGL, to which SFC transferred the shares of its subsidiaries (and indirectly the assets they held and businesses they carried on): sections 4.1, 6.4 and 6.6. Included among the assets transferred to EPGL were "SFC Intercompany Claims" defined to include amounts owing to SFC by any of its subsidiaries: section 4.10. The Plan provides that all obligations and agreements to which EPHL or EPGL

[4] See note 2.
[5] See note 3.

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became parties as a result of the transfer to them “shall be and remain in full force and effect, unamended”: section 8.2(j).

[77] All equity holders in SFC released their claims against SFC: section 4.5. Noteholder Class Action claims against SFC were released: section 4.4. Affected Creditors – comprised mainly of SFC’s noteholders, whose claims had been secured by first-priority security interests over the shares of SFC’s subsidiaries – released SFC from their claims for payment of principal and interest on the notes: section 4.1. Article 7 specified individuals and entities also released by the Plan. The appellant was not one of the specified individuals.

(g) Analysis of The Appellant’s Plan Preclusion Arguments

[78] In light of the principles of interpretation, the factual matrix, the purposes of the *CCAA* and the Plan, and the Plan’s language, I turn now to the analysis of the appellant’s plan preclusion arguments.

(i) No Right to Advance Claims Advanced in the Class Actions

[79] The appellant argues that the claims made in the action are not Causes of Action that were transferred to the Litigation Trust because they are the same as, or overlap with, the claims made in the Class Actions. He asserts that the claims in this action on the one hand, and those in the Class Actions on the other, rely on the same or similar allegations of wrongdoing by the appellant and claim the same or similar amounts, based on the amounts that SFC raised, as debt or

equity, in the capital markets. He also argues that there is an overlap in who will benefit from the claims, in that certain creditors are beneficiaries of the Litigation Trust and class members in the Class Actions.[6] The “greater certainty” language of the Plan makes it clear, he maintains, that these claims were not transferred.

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[80] I would not give effect to this argument.

[81] The Plan, by the combination of section 6.4(o) and the definition of Litigation Trust Claims, transferred to the Litigation Trust two types of Causes of Action held by two different persons. First, it transferred Causes of Action of SFC against any and all third parties. Second, it transferred Causes of Action of the Trustees on behalf of Noteholders against any and all persons for certain matters. The respondent relies upon the first transfer only, that is, the transfer of Causes of Action that SFC had against the appellant. The trial judge did not err in concluding that the causes of action the respondent advanced in this action are Causes of Action that SFC had against the appellant. This differentiates them from causes of action of SFC stakeholders, which are being advanced in the Class Actions.

[6] There is an overlap between this argument, and the appellant’s argument that in assessing damages the trial judge awarded the respondent amounts that could only be claimed in the Class Actions or were duplicative of those amounts. However, I have addressed the points as distinct. One argument is essentially about the respondent’s standing to assert certain claims. The other is about whether, even if he has standing, the damages actually awarded were appropriate.

[82] A wrong (such as a tort) done to a corporation is actionable by the corporation which is entitled to recover the loss it suffered. The shareholders and creditors of a corporation cannot sue for damage to the corporation, even though they are indirectly affected by it: *Hercules Management Ltd. v. Ernst and Young,* [1997] 2 S.C.R. 165, at para. 59; *Meditrust Healthcare Inc. v. Shoppers Drug Mart* (2002)*,* 61 O.R. (3d) 786 (Ont. C.A.), at paras. 11-16. Similarly, an action for breach of a corporate director's or officer's fiduciary duty is an action of the corporation, whether it seeks damages or an accounting of profits: *BCE Inc. v. 1976 Debentureholders,* 2008 SCC 69, [2008] 3 SCR 560, at para. 41; *Midland Resources Holding Limited v. Shtaif,* 2017 ONCA 320, 135 O.R. (3d) 481, at paras. 148-149 and 156, leave to appeal refused, [2018] S.C.C.A. No. 541.

[83] On the trial judge's findings, the appellant was a fiduciary of SFC and he breached his fiduciary duty to it. SFC was the victim of the appellant's tort – his fraud – in that it was SFC that was caused to record fictitious or overstated assets and revenues on its financial statements, SFC that was caused to raise money from the public and incur obligations to lenders and others that it would not otherwise have incurred, and SFC's funds, received through these activities, that were invested and lost in illegitimate businesses or consumed by the consequence of the discovery of the fraud. Leaving aside the question of how

damages for these matters are assessed, the causes of action to sue for them were Causes of Action of SFC.

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[84] The Plan transferred to the Litigation Trust Causes of Action "that have been or may be asserted by or on behalf of … SFC against any and all third parties…", a term which would include the appellant: section 1.1. The appellant's contention could only be correct if there were something in the Plan that restricted the meaning that would otherwise be given to that transfer language. The provision of the Plan relied upon by the appellant for this effect is the "greater certainty" clause in the definition of Litigation Trust Claims, which reads as follows: "For greater certainty: (x) the claims being advanced or that are subsequently advanced in the Class Actions are not being transferred to the Litigation Trust; and (y) the claims being transferred to the Litigation Trust shall not be advanced in the Class Actions". Like the trial judge, I do not read that phrase to have the meaning for which the appellant argues.

[85] First, as the trial judge correctly noted, the claims made in the Class Actions are claims made on behalf of noteholders and equity holders for their causes of action arising from damages they suffered. SFC did not make claims in the Class Actions asserting SFC Causes of Action or seeking damages SFC suffered. The distinction is important and is not undermined by either the factual overlap in the

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claims or the fact that certain creditors are or may be both beneficiaries of the Litigation Trust and members of the plaintiff classes.

[86] On the point of factual overlap, the same or similar facts may give rise to a cause of action by a shareholder and one by the corporation. The law recognizes that "…where a shareholder has been directly and individually harmed, that shareholder may have a personal cause of action even though the corporation may also have a separate and distinct cause of action" (emphasis added): *Hercules,* at para. 62. Shareholders and noteholders may have causes of action arising from misrepresentations made to them when acquiring securities, based on common law doctrines or under securities legislation. And where they do, they may have rights to sue for damages they personally have suffered. But the existence of those causes of action does not detract from the existence of a separate and distinct cause of action of the corporation, based on wrongdoing against or breach of duties owed to it, to sue for damages it has suffered.

[87] As for the argument that, because creditors of SFC are Litigation Trust beneficiaries, the causes of action asserted by the Litigation Trust are or become indistinguishable from their personal rights of action, in my view this court's decision in *Livent Inc. v. Deloitte & Touche,* 2016 ONCA 11, 128 O.R. (3d) 225, rev'd in part on other grounds, 2017 SCC 63, [2017] 2 S.C.R. 855, stands as a complete answer to that proposition.

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[88] In *Livent*, it was held that the distinction between the corporation's cause of action arising from wrongs done to it to recover damages it has suffered and the separate cause of action of a corporate stakeholder to assert a personal cause of action for a wrong done to her for damages she has suffered, does not cease to apply when the corporation is insolvent and intends to distribute any recovery to its stakeholders. In other words, the separate and distinct cause of action of the corporation does not become one and the same as the stakeholders' cause of action even if the corporation's intention is to benefit its stakeholders with any recovery. Blair J.A. explained why an argument to the contrary must be rejected, observing, at para. 57, that:

> It impermissibly conflates damages sustained by the corporation with the distribution of those damages, once recovered, to creditors and other stakeholders, as part of the assets of the corporation, in the course of the proceeding under the [*CCAA*]…. To conflate them is to disregard the long-recognized principle of corporate law that a corporation is a legal entity separate apart from its shareholders and stakeholders, and that the corporation alone has the right to sue for wrongs done to it. [Citations omitted.]

[89] The Litigation Trust is the *CCAA* vehicle for the pursuit of SFC's corporate causes of action and the distribution of its damages, once recovered, to creditors. Thus the statement from *Livent* is equally applicable here. The Plan's stated purpose of benefiting creditors by recoveries achieved by the Litigation Trust does not affect the distinction between SFC's causes of action (pursued through

the Litigation Trust) and any personal causes of action that creditors or others may pursue, including in the Class Actions. That distinction continues.

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[90] In addition to conflicting with well-established corporate law principles, the appellant's attempt to divorce the concept of a cause of action from the person or corporation that holds it conflicts with the language of the Plan. In defining the Litigation Trust Claims transferred to the Litigation Trust, the Plan refers to Causes of Action that have been or may be asserted on behalf of SFC and those that have been or may be asserted on behalf of the Trustees for the Noteholders. It links the Causes of Action transferred to the entity that held them. The "greater certainty" language in this definition must be read in the same way. The fact that the causes of action of shareholders' and noteholders' advanced in the Class Actions were not transferred to the Litigation Trust under the Plan has no bearing on the transfer of SFC's separate and distinct Causes of Action to the Litigation Trust, even if arising from the same or similar facts and even though creditors are beneficiaries of the Litigation Trust. SFC's Causes of Action were not being advanced in the Class Actions. The "greater certainty" language consequently does not have the effect for which the appellant contends.

[91] Stepping back from the precise wording of the Plan, the appellant argues more generally that it represented a bargain that his wrongs would be pursued in the Class Actions only. I do not accept this argument, which does not find

support in the text of the Plan, read in light of the factual matrix and the purposes of the Plan and the *CCAA*.

[92] The Class Actions pre-dated the Plan. If they were intended to be the sole vehicle for recovery from the appellant, it is unclear why the appellant did not receive a release from SFC or the Litigation Trust under the Plan. Moreover, when the Plan was put forward and approved, the failed sales process had already established that recoveries from assets in SFC subsidiaries would be insufficient to allow SFC to satisfy creditor claims, making other sources of recovery, including enforcement of SFC's litigation rights, important. There is no reason why rights of action of SFC against the appellant, which would continue to exist in a bankruptcy or liquidation of SFC, would be given up in this *CCAA* Plan, where the object was to maximize recoveries in a manner more advantageous than bankruptcy or liquidation. Moreover, the stated purpose of the Plan includes allowing creditors to benefit from the pursuit of contingent claims by the Litigation Trust. Morawetz J., in granting the Sanction Order approving the Plan, noted that it provided the opportunity "through the Litigation Trust, to pursue (in litigation or settlement) those parties that are alleged to share some or all of the responsibility for the problems that led SFC to file for *CCAA* protection": *Re Sino-Forest Corporation*, at para 65. When the Plan was approved, the appellant was

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already alleged to be one of those persons, but on the appellant's argument the opportunity Morawetz J. identified would not exist.

[93] The purposes of the *CCAA* and the Plan, and the Plan's precise provisions read in light of the factual matrix, all rebut the appellant's characterization of the Plan as preventing the Litigation Trust from pursuing a claim that SFC could have pursued against the appellant for his misconduct.

[94] Accordingly, the trial judge did not err in interpreting the Plan as allowing the respondent to advance the claims made in this action against the appellant notwithstanding the claims by noteholders and shareholders advanced in the Class Actions.

(ii) Excluded Litigation Trust Claims

[95] The appellant's second argument is that the claims advanced in the action are Excluded Litigation Trust Claims. As noted above, that exclusion applies where there is an agreement between SFC and a category of its creditors that a particular claim is excluded from those transferred to the Litigation Trust. The Plan specifies one category of excluded claim, encompassing certain claims against SFC's underwriters. There is no similar particularization of claim(s) of SFC against the appellant which are excluded.

[96] The only agreement to exclude a claim of SFC against the appellant that the appellant points to is the "greater certainty" language providing that claims

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advanced in the Class Actions are not transferred to the Litigation Trust. The argument is therefore just a repackaging of the appellant's first argument, as it depends for its validity on the Plan having exempted claims arising from facts asserted in the Class Actions from those Causes of Action of SFC transferred to the Litigation Trust. As previously discussed, the Plan does not have that effect.

[97] I would therefore not give effect to this argument.

(iii) SFC Intercompany Claims

[98] The appellant's third argument is that the claims for which he was found liable are SFC Intercompany Claims. He argues that these were assigned under the Plan by SFC to EPHL and EPGL, rather than to the Litigation Trust.

[99] I agree with the appellant that SFC Intercompany Claims were not assigned to the Litigation Trust, but I disagree that the claims for which the appellant was found liable in this action are SFC Intercompany Claims.

[100] SFC Intercompany Claim is defined in the Plan as "any amount owing to SFC by any Subsidiary or Greenheart and any claim by SFC against any Subsidiary or Greenheart". SFC's shares in each Subsidiary and in Greenheart were transferred under the Plan to EPHL and by EPHL to EPGL. The SFC Intercompany Claims followed the same route: section 4.10.

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[101] Essentially, the appellant's argument is that the respondent is claiming money raised by SFC in the capital markets that was invested in its subsidiaries and lost. In his submission, a claim about funds invested in SFC's subsidiaries and not returned is an SFC Intercompany Claim, regardless of against whom it is made.

[102] I disagree. In my view, reading the Plan in accordance with the interpretive principles noted above yields the conclusion that what was transferred to EPHL and then to EPGL were the debt obligations of *subsidiaries* or *Greenheart* to SFC and the rights SFC had to claim against *those entities*. This makes commercial sense in light of the words used in the definition of SFC Intercompany Claim – "any amount owing to SFC by any Subsidiary or Greenheart and any claim by SFC against [them]". It also makes sense in light of the fact that the shares of the Subsidiaries and Greenheart were being similarly transferred. It would not make commercial sense for EPHL and EPGL to acquire the shares in SFC's subsidiaries but to leave the subsidiaries exposed to SFC's claims against them. The concluding words of section 4.10 of the Plan make this clear: "[T]he applicable Subsidiaries and Greenheart shall be liable to [EPGL] for such SFC Intercompany Claims from and after the Plan Implementation Date".

[103] SFC Intercompany Claims does not refer to claims against the appellant arising from his conduct, even though that conduct involved investing SFC's

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funds in the company's subsidiaries. The transfer to EPGL of SFC's claims against its subsidiaries and Greenheart did not include the transfer of SFC's causes of action against the appellant.

[104] I would accordingly reject this argument.

(iv) Conclusion on Appellant's Plan Preclusion Arguments

[105] I would not give effect to the appellant's arguments that the trial judge erred in concluding that the Plan transferred the claims advanced in this action to the Litigation Trust and did not preclude them from being advanced against the appellant by the respondent.

(2) ***Causation and Damages***

(a) The Appellant's Arguments

[106] The appellant argues that, even if the claims made in the action were SFC's Causes of Action, that only takes the respondent so far. As transferee of Causes of Action of SFC, the respondent can only claim amounts that would have been properly claimable by SFC. Thus the only damages that could be claimed were damages of SFC proved to have been caused by the appellant's wrongdoing. In interrelated arguments, the appellant submits that the damages that were awarded by the trial judge are not damages of SFC, nor was it appropriate to consider them as caused by the appellant's wrongdoing.

[107] The appellant submits that the core of the claim is for losses incurred by debt and equity holders and that the amounts raised from them, if acquired by fraud as the respondent alleges, never belonged to SFC and therefore could not form part of SFC’s loss. He argues that allowing such a claim improperly creates the risk of double recovery.

[108] The appellant goes on to submit that the trial judge simply presumed the appellant to have caused everything that led to SFC’s ultimate collapse. He argues that the trial judge should have: required proof that each transaction that occurred would not have occurred without the appellant’s deceit; calculated, for each transaction so found, the loss resulting from it and; accounted for transactions on which there was no loss.

[109] Finally, he argues that the trial judge applied incorrect principles of damages assessment. The Steger primary approach should have been completely rejected in favour of a transaction-by-transaction analysis. Even the specific loss analysis that the trial judge performed is flawed as it would, in part, award SFC damages which could only have been suffered by its subsidiaries.

[110] For the reasons that follow, I would not give effect to the appellant’s principal causation and damages arguments or disturb the trial judge’s award of damages. Accordingly, it is unnecessary to address the appellant’s arguments

about whether and how the trial judge’s alternative damages calculation should be adjusted.

(b) The Standard of Review

[111] Causation is a question of fact, and is reviewed on a deferential standard. Absent palpable and overriding error, appellate intervention is not warranted: *Ediger v. Johnston,* 2013 SCC 18, [2013] 2 S.C.R. 98, at para 29.

[112] A trial judge’s assessment of damages attracts considerable deference. It will not be interfered with absent an error of principle or law, a misapprehension of evidence, a showing that there was no evidence on which the trial judge could have reached his or her conclusion, a failure to consider relevant factors or consideration of irrelevant factors, or a palpably incorrect or wholly erroneous assessment of damages: *Naylor Group Inc. v. Ellis-Don Construction Ltd.*, 2001 SCC 58, [2001] 2 S.C.R. 943, at para. 80; *Rougemount Capital Inc. v. Computer Associates International Inc.*, 2016 ONCA 847, 410 D.L.R. (4th) 509, at para. 41.

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(c) Analysis of The Appellant’s Causation and Damages Arguments

(i) The Trial Judge’s Factual Findings Appropriately Underpin His Causation Conclusion and Damages Assessment

[113] The trial judge’s causation conclusion and his assessment of damages are conceptually linked. They both are premised on five core factual findings that he made.

[114] The first was that SFC’s raising of money in the debt and equity markets was something which was caused by the appellant’s wrongdoing, including his misrepresentation of BVI standing timber as a valuable asset. The second was that “but for Mr. Chan’s deceit, [SFC] would never have undertaken obligations of this magnitude to lenders and shareholders”. The third was that but for the appellant’s wrongdoing, SFC would not have “entrusted this money [the funds raised on the capital markets] to [the appellant] and Inside Management.” Fourth was his finding that the appellant, “rather than directing [SFC’s] spending on legitimate business operations, poured hundreds of millions of dollars into fictitious or over-valued lines of business where he engaged in undisclosed related-party transactions and funnelled funds to entities that he secretly controlled”: at para. 1022. Fifth was the finding, at para. 1020, regarding the impact of the fraud and its discovery:

> When the fraud was uncovered, and the dust settled, more than half of the money was gone. To the extent those funds went into the acquisition of assets, the value of those assets was realized through the EPHL sales process. What was left in cash on June 2, 2011 was largely consumed in propping up and managing the enterprise during the extended crisis brought on by the disclosure of the fraud and its ongoing investigation including the ongoing concealment by [the appellant] and Inside Management.

[115] These five findings underlie the trial judge's conclusion that what occurred was a chain of events all flowing from the appellant's fraud and breach of duty, which resulted in the loss of the funds that had been raised. As he put it: "[t]he loss of these funds to [SFC] was directly related to Mr. Chan's fraud and breach of fiduciary duty": at para. 1022.

[116] In my view, these findings were available to the trial judge on the record. The argument that the trial judge simply presumed the appellant to be responsible for everything that led up to SFC's ultimate collapse is without foundation.

(ii) There Is No Legal Error In the Trial Judge's Causation Analysis

[117] The trial judge applied the appropriate legal principles to his causation analysis. He approached the "but for" causation test on the robust common sense approach the law contemplates: *Clements v. Clements,* 2012 SCC 32, [2012] 2 S.C.R. 181, at para. 46; *Snell v. Farell*, [1990] 2 S.C.R. 311, at para. 34. Moreover, he was alive to the need to be satisfied that the loss was caused by

the chain of events flowing from the wrongdoing after considering whether there were intervening causes that broke the chain of causation: *Canson Enterprises Ltd. v. Boughton & Co.,* [1991] 3 S.C.R. 534, at paras. 9, 47, 52, and 54-57.

[118] The appellant argues that the trial judge did not take into account other causes for the discrepancy between the value of SFC's assets, held by its subsidiaries, and the value of the funds invested in them. Not all of the subsidiaries' activities were found by the trial judge to be fictitious. Therefore external factors, such as climate, industry pricing etc., may have caused the losses, rather than the appellant's fraud.

[119] In my view the trial judge was entitled to reject this argument. He did not ignore the fact that not all of the businesses were fictitious. He found that a loss was caused by the appellant notwithstanding that finding. His approach credited the value actually existing in the subsidiaries. And, since once a loss arising from a fraud or breach of duty is established, it is the defendant who bears the onus of showing that the plaintiff would have suffered the same loss absent the defendant's wrongdoing, the trial judge was not required to give effect to unproven alternative causes: *Rainbow Industrial Caterers Ltd. v. Canadian National Railway*, 1991 SCC 27, [1991] 3 S.C.R. 3, at pp. 15-16: *Hodgkinson v. Simms,* [1994] 3 S.C.R. 377, at pp. 441-2.

(iii) The Trial Judge Did Not Award Compensation For Amounts That Could Not Be Legally Considered Losses of SFC

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[120] The appellant submits that the trial judge's analysis contains a fundamental flaw because the trial judge proceeded as though the money that SFC raised on the debt and equity markets "belong[ed] to the corporation" and its loss was a loss to SFC. This could not be, the appellant argues, since if the funds were raised "[b]ased on fraudulent misrepresentations about the nature and value of the BVI standing timber assets", as the trial judge found, the funds would have been impressed with a trust in favour of the shareholders and noteholders who advanced the funds. Only they, not SFC, would have a right to claim for the loss of these funds. Moreover, allowing a claim for these funds would involve SFC in inconsistent positions – complaining that funds were obtained on its behalf through fraud while trying to obtain the benefit of those very funds.

[121] In making the latter argument, the appellant relies on the Supreme Court of Canada's decision in *Corporation Agencies Ltd. v. Home Bank of Canada*, [1925] S.C.R. 706. In that case, an individual engaged in a fraudulent cheque kiting scheme, making unauthorized deposits into Corporation Agencies' bank account followed by equally unauthorized withdrawals. Corporation Agencies sued the bank alleging it should not have honoured the unauthorized withdrawals.

Success on that claim would have given it the benefit of the unauthorized deposits.

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[122] In rejecting the claim, the majority of Supreme Court held, at p. 726, that the plaintiff could not accept part of the fraudulent scheme – the part that saw money deposited to its account - while relying on the fraud to dispute withdrawals that had been made pursuant to the same fraudulent scheme.

[123] In my view, this case does not assist the appellant because it is distinguishable on two fundamental points. Corporation Agencies was suing a party who was not the perpetrator of the fraud and was seeking to benefit from part of the fraud at that party's expense. Here, the claim is not against an innocent party, but against the perpetrator, for damages caused by the fraudulent scheme. Nothing in the Supreme Court's decision precludes that type of claim. Moreover, in *Corporation Agencies,* the plaintiff did not establish that the monies deposited into its account were funds for which it would have to account to others: at p. 726. Here, SFC had obligations in respect of the funds raised on the capital markets, which the appellant's fraud deprived it of the ability to meet.

[124] I do not have to decide if the appellant's trust characterization is correct, as it does not support his position. The trial judge found that SFC had suffered damage because it raised money on the capital markets, incurred obligations to its shareholders and noteholders by doing so, and then lost the money raised,

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none of which would have occurred but for the appellant’s misconduct. The result was to leave SFC with the obligations it took on when it raised the funds while depriving it of the means to honour those obligations.

[125] This analysis would not change if the monies raised were, as the appellant argues, “impressed with a trust in favour of the shareholders and noteholders who advanced the funds”. By reason of the appellant’s fraud, SFC would still have been left with obligations to its shareholders and noteholders – though trust obligations – while having been deprived of the means of honouring them. It would still have suffered damage, and accrued a cause of action to recover for that damage.

[126] The trial judge did not commit a legal error by considering the loss of the funds raised to have been a loss suffered by SFC in these circumstances. Where directors cause a corporation to incur liabilities and misapply money which should have been paid to answer those liabilities, leaving the company with large liabilities and no means of paying them, the directors cause the corporation to suffer a recognizable form of loss: *Bilta (UK) Ltd v. Nazir (No. 2)*, 2015 UKSC 23, [2015] 2 WLR 1168, at paras. 176-178. That proposition was accepted by this court in *Livent*: at para. 349.

[127] Nor is the result changed because, as the appellant argues, SFC was ultimately released by the Plan from its obligations to equity holders and

creditors. The appellant submits that the release undercuts the argument that SFC was left with obligations it could not honour by reason of the appellant's conduct. I disagree. The fact that the Plan ultimately released SFC from its obligations to creditors and equity holders from whom funds were raised does not undermine the causation or damages conclusions of the trial judge.

[128] The release of SFC by creditors does not result in a windfall gain. Absent the Plan, if SFC had itself pursued its claims against the appellant, it could have used any damages it recovered towards satisfying its creditors. The Plan transferred the right to pursue SFC's claims to the Litigation Trust together with the obligation to distribute damages, once recovered, to the creditors who are the beneficiaries of the Litigation Trust. Effectively, the Litigation Trust assumes and replaces SFC's obligations to creditors through its obligation under the Plan to distribute damages it recovers to beneficiary creditors. Releasing SFC's obligations to creditors and requiring the Litigation Trust to distribute damages it recovers to beneficiary creditors ensures that the obligations to creditors rests with the person that will recover the damages.

[129] Similarly, the release of SFC by equity holders does not result in any windfall. Under s. 6(8) of the *CCAA*, unless all creditor claims are to be paid in full, a plan may not provide for payment of equity claims. "…(I)n enacting s. 6(8) of the *CCAA*, Parliament intended that a monetary loss suffered by a shareholder

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(or other holder of an equity interest) in respect of his or her equity interest not diminish the assets of the debtor available to general creditors in a restructuring": Re *Sino-Forest Corporation,* 2012 ONCA 816 at para 56. The fact that the Plan does not provide for equity holders to benefit from the Litigation Trust thus follows the priorities set by the *CCAA* for the distribution of recoveries from the enforcement of an SFC asset.

[130] It would be contrary to the purpose of the Plan, and the Litigation Trust it provided for, to give the release of SFC under the Plan the effect for which the appellant contends. The Litigation Trust was a vehicle to allow recoveries from persons whose conduct caused damage to SFC. The appellant's argument would treat the Plan as effectively having released him from being pursued for causing that damage, something the Plan did not do.

(iv) The Double Recovery Doctrine Does Not Apply

[131] The appellant argues that the trial judge's assessment of damages creates the risk of double recovery from him. He argues that a judgment against him should not issue because "a defendant cannot be liable twice for the same alleged loss". Reduced to its bare essentials, the appellant's position is that the funds raised by SFC on the debt and capital markets are at the core of both the claims in the Class Actions and the award of damages in this action. Even if separate causes of action and rights to damages exist, the damages award in

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this action will undoubtedly overlap with what may be awarded against him in the Class Actions.

[132] I would not give effect to this argument. Since SFC has a separate and distinct cause of action and suffered a recognizable form of loss, neither the cause of action nor recovery for it can be defeated by an argument that the appellant's conduct also gave rise to causes of action in others who may seek to claim their own damages from him, even if in similar amounts.

[133] The appellant invokes the rule against double recovery, but his position does not attract the rule, properly understood. The rule does not prevent a party with a claim from obtaining a judgment for 100% of its losses. The rule only prevents a party who has made a recovery on a judgment from recovering, through other actions, more than 100% of those losses. "It is not the *damage award* that amounts to satisfaction and bars a second action but the *recovery* by the plaintiff in the first action" (emphasis in original): *The Treaty Group Inc. (Leather Treaty) v. Drake International Inc.*, 2007 ONCA 450, 86 O.R. (3d) 366, at para 13. The rule has no application here, where it is raised to avoid judgment

against the appellant[7]. There is no suggestion that the Litigation Trust has already recovered 100% of the losses it is entitled to claim.

[134] To the extent that the appellant raises the spectre of beneficiaries of the Litigation Trust achieving double recovery in the future if they receive benefits from the Litigation Trust's collection of the judgment against him and then are successful in the Class Actions against him, this is not an objection to the judgment in this action for the reasons set out above.

[135] As the trial judge noted, it is in the recovery stage of the Class Actions that any issue of double recovery would have to be raised to the extent that members of the class attempt to recover damages already recovered through the Litigation Trust. For that issue to even emerge, the appellant would first have to pay the judgment granted against him in this action and then the plaintiffs in the Class Actions would have to fail to appropriately credit any distributions they receive. Neither precondition has occurred. Speculating on whether they will is inappropriate here. The point is that the rule against double recovery does not assist the appellant in resisting the granting of the judgment under appeal.

[136] As an alternative basis to his finding that the prospect of double recovery did not stand as a bar to the respondent's action, the trial judge interpreted the

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[7] The appellant clarified in oral argument that double recovery was raised to avoid judgment against the appellant, not to reduce any damage award made against him. Indeed, the appellant did not point to any recoveries that had been made against him.

Plan to limit Class Action recoveries against the appellant to $150 million; thus, the overlap of claims would only be to the extent of $150 million, and not to the entirety of the respondent's claim. The appellant argues that the trial judge misinterpreted the Plan, which does not limit the Class Action claims against him.

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[137] Any error in the trial judge's interpretation of the Plan in this respect was immaterial. He advanced the point as an alternative only to the main point that the prospect of later recoveries in the Class Actions could not stand as a bar to the appellant's liability to pay damages in this action.

[138] I would therefore not give effect to this ground of appeal.

(v) The Trial Judge Applied The Correct Principles of Damages Assessment

[139] Given that the trial judge properly found causation of a recognizable form of loss to SFC, the measurement of that loss fell squarely within the trial judge's broad powers to assess damages. I see no reason to interfere with that assessment, which was based on his findings of fact and acceptance of expert evidence consistent with the chain of causation he found to exist.

[140] The trial judge referred to the measure of damages for deceit. He correctly described it as the difference between the financial position of the plaintiff as a result of the fraud, including losses flowing from it even if not foreseeable at the time of its commission, and the financial position of the plaintiff as it would have

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been if the tort had not occurred: para 928, citing *Rainbow Industrial Caterers Ltd. v Canadian National Railway* (1990), 67 D.L.R. (4th) 348 (B.C.C.A.), at p. 359, aff'd,1991 SCC 27, [1991] 3 S.C.R. 3. Elsewhere in his reasons he referred to the principles of equitable compensation citing, among other authorities, this court's decision in *Whitefish Lake Band of Indians v. Canada (Attorney General),* 2007 ONCA 744, 87 O.R. (3d) 321. He noted that "equitable compensation is concerned with restoration of the actual value of the thing lost through the breach of duty, in this case [SFC's] funds raised on the capital markets" and that compensation is assessed at the date of trial and with the presumption that trust funds will be invested in the most profitable way: at paras 1007 to 1011.

[141] The appellant says the trial judge erred by awarding damages based on the full equitable measure of compensation, which is only appropriate where property is owned by a beneficiary but is controlled by the fiduciary as trustee. He relies on the distinction between cases of breach of trust and those of breach of a non-trust fiduciary duty made in *Whitefish Lake Band of Indians*, at para. 54, and *Canson Enterprises,* at p. 578. In *Canson Enterprises,* the Supreme Court stated that in cases of breach of trust, "the concern of equity is that [the trust property] be restored … or, where that cannot be done, to afford compensation for what the object would be worth", whereas in cases of breach of duty, "the concern of equity is to ascertain the loss resulting from the breach of the particular duty": at

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p. 578. The court went on to observe that, in determining the loss resulting from breach of a particular fiduciary duty, equity may borrow common law concepts like remoteness, intervening cause, and mitigation to avoid undue harshness: at p. 579-80, 585-586, and 588. The appellant argues that since the claim against him did not involve a breach of duty in respect of funds of SFC that he controlled, the trial judge should have assessed damages based on these common law principles.

[142] I would not give effect to that complaint for a number of reasons. First, on the trial judge’s findings, the appellant had control over the funds raised by SFC, which the trial judge found to have been “entrusted” to the appellant and “directed” by him into various entities to which he was related or which he secretly controlled. The trial judge properly concluded on the basis of these findings that the appellant “owed fiduciary duties towards [SFC] akin to those of a trustee”: at para. 923.

[143] Second, even if the principles of equitable compensation applicable where trust property is involved were not available, the trial judge’s damage assessment can be justified based on the principles in *Canson Enterprises*. As I have discussed above, the trial judge properly considered causation and potential intervening acts in coming to his damages award, and remoteness does not appear to be an issue.

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[144] In any event, in my view the trial judge's assessment of damages was in fact primarily based on the tort measure of damages. His reference to equitable compensation principles was made primarily in relation to a point the appellant's expert made, namely that when credit was given for asset realizations, the Greenheart realization should have been adjusted to take into account what Greenheart was worth when SFC made its investment, not what it ultimately was sold for. The trial judge rejected that argument. He said: "The fact that the discovery of [the appellant's] fraud had a negative effect on the market value of the Greenheart asset is not a market risk [SFC] has to bear… It is sufficient that [SFC] suffered a loss in fact, provided the realization was not improvident": at para. 1101.

[145] The trial judge's treatment of the Greenheart transaction is fully justified under the equitable principles of compensation applicable to a case where trust property is not involved. In *Hodgkinson*, the Supreme Court clarified that its observations in *Canson Enterprises* did not "signal a retreat from the principle of full [equitable] restitution" in all cases of breach of duty, as the appellant contends: at p. 443. The majority rejected the defendant investment advisor's argument that the plaintiff's loss was caused by the market rather than his breach of duty, holding that it was appropriate to place the risk of market exigencies on the defaulting fiduciary: at pp. 442, 452-3. It observed that breach of fiduciary

duty can take a variety of forms, and consequently different approaches may be appropriate to remedy the harm caused by different breaches: *Hodgkinson,* at pp. 443-444. Here, as in *Hodgkinson,* there was a strong nexus between the wrong complained of, the fiduciary relationship, and the risk of market volatility that contributed to SFC's loss. The appellant's wrongdoing involved abuse of his fiduciary role and breach of the duty of loyalty to the corporation that lay at its core: at pp. 445, 452-453. This is exactly the type of case that justifies placing the risk of market fluctuations on the appellant.

[146] The trial judge's reasons for rejecting the appellant's expert's proposed adjustment of the realization amount for Greenheart were also justified under a deceit measure of damages. As the trial judge found, the appellant knew or could be deemed to have known that the discovery of his fraud would send SFC "into a tailspin": at para. 1012. The effect that had on the timing and distressed circumstances in which assets were realized can be seen as part of the chain of events flowing from the appellant's fraud: *Rainbow* (B.C.C.A.), at p. 359; *Canson Enterprises, at p. 565; Hodgkinson,* at pp. 445-6. This conclusion reflects the reality that as courts strive to treat similar wrongs similarly, equitable and common law paths often produce the same result: *Hodgkinson,* at p. 444-5, *Canson Enterprises,* at p. 585-6.

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(3) *The Doctrine of Election*

[147] The appellant argues that the equitable doctrine of election, also known as the rule against approbation and reprobation, prohibits a party from asserting that a transaction is valid to obtain some advantage and then turning around to assert that it is invalid to secure some other advantage. The transfer, under the Plan, of SFC's assets to EPGL (and the subsequent transfers to third-party purchasers) constituted an election to treat the assets as valid and subsisting, since the Plan deemed obligations and agreements to which EPGL became a party "in full force". The equitable doctrine of election, which he contends the trial judge erred in failing to consider, should prevent the respondent from making the inconsistent argument that the assets were fictitious, fraudulent, tainted or overvalued as a product of his fraud.

[148] I would not give effect to this argument. First, the cases relied upon by the appellant deal with markedly different situations to the one at bar. As one example, in *Kin Tye Loong v. Seth* (1920), 1 C.B.R. 349 (P.C.), the plaintiff filed a claim in the defendant's bankruptcy for the price of goods sold and delivered, received a dividend on that claim, and compromised and released it. This conduct – consistent only with the position that a valid sale had taken place – barred a subsequent action by the plaintiff claiming that no sale in fact had taken place, that property in the goods had never been transferred, and that damages

should be paid for conversion of what the plaintiff alleged were still its goods. Nothing analogous is present here.

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[149] Second, the language of the Plan cannot be read as elevating the nature or value of what was transferred under the Plan above what actually existed. For example, at the time of the Plan, the standing timber assets had not been located or verified and the trial judge found they were and had been fictitious. SFC’s insolvency, which gave rise to the Plan, arose from, among other things, that very circumstance. In the sale to New Plantations effected by EPGL, the standing timber assets were ascribed no value unless recoveries on them were made, but none occurred. Nothing in the Plan or the steps taken under it can be read to treat the non-existent as existing, or the valueless as valuable, preventing the Litigation Trust from maintaining that the fraud alleged had occurred.

[150] This court has recently explained the doctrine of election in both its common law and equitable aspects. At common law, the doctrine addresses the consequences of a party choosing between inconsistent alternatives; the choice of one alternative, for example, to affirm a contract, forecloses later choice of an inconsistent alternative, for example, to rescind the same contract. The equitable doctrine of election precludes a party who has accepted benefits under a particular instrument, for example, a will, from refusing to accept the balance of

the provisions of that instrument: See *Charter Building Company v. 1540957 Ontario Inc.*, 2011 ONCA 487, 107 O.R. (3d) 133, at paras. 18-22.

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[151] The trial judge correctly held that there had been no election between inconsistent rights here. The transfer of SFC's assets to EPGL and the transfer of its claims against the appellant for fraud and breach of fiduciary duty to the Litigation Trust were not inconsistent. The Plan contemplated that the benefit of both would be preserved and pursued. This conclusion, reached by the trial judge upon consideration of the common law doctrine of election (the parties before us disagreed as to whether the equitable doctrine was argued before the trial judge), is equally applicable to the equitable doctrine. The Litigation Trust's acceptance of benefits under the Plan, namely the transfer of SFC's Causes of Action for fraud and breach of fiduciary duty, are not accompanied by any refusal to accept the burden of giving effect to other dispositions under the Plan, such as the obligation to distribute damages, once recovered, to the creditors who are the beneficiaries of the Litigation Trust, and the transfers of SFC's assets to EPGL, enabling the sales to subsequent purchasers. Indeed, the damages awarded by the trial judge deducted the value implied by the recovery from those sales.

[152] As the trial judge noted, even where a party has elected to affirm a contract, its right to damages is not precluded. The same principle would apply here to the argument about the equitable doctrine of election. Nothing suggests

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that a party is foreclosed from pursuing damages when, as a result of being defrauded, its loss is mitigated by the disposition of whatever property was acquired in transactions affected by the fraud. Indeed, the measure of damages available to a party induced by fraud to enter into a transaction involves the calculation of the loss the plaintiff suffered, which usually requires a credit to be given for the actual value of the property that was acquired: Lewis N. Klar & Cameron Jefferies, *Tort Law*, 6th ed. (Toronto: Thompson Reuters, 2017), at p.815.

[153] In my view, the doctrine of election is of no assistance to the appellant.

(4) *Errors in Factual Findings*

[154] The appellant argues that the trial judge made two fundamental errors in his treatment of the evidence, which undermine his factual conclusions. First, the appellant argues that the trial judge drew the inference that the BVI standing timber model was a fraud based on one sample transaction for which the documentation had been translated into English. He goes on to argue that the inference that all of the 525 transactions conducted under the BVI standing timber model were the same as the sample transaction was impermissible for two reasons: first, fraud in numerous transactions cannot be proven by reference to one example and, second, that proceeding as the trial judge did required the conclusion that the other transactions, comprised of documents which had not

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been translated into English, were substantially similar to the sample when those non-translated documents were inadmissible under the *Courts of Justice Act*, R.S.O. 1990, c. C. 43, s. 125(2).

[155] The trial judge considered the argument that one sample was not sufficient and rejected it. He stated that all of the purchase and sale contract documentation for all the transactions was in evidence and available to both parties and that trial and judicial economy dictated that unless absolutely necessary, time should not be devoted to the proof of every piece of documentation for all 525 transactions. Rather, if the defendant had wanted to quarrel with the assertion that the sample transaction was essentially the same as the rest of them, he had the raw material necessary to do that. He did not attempt to do so.

[156] For the reasons given by the trial judge, and the following additional reasons, I would not give effect to the appellant's argument:

a) The requirement that fraud be proven by clear and cogent evidence does not mean, as a matter of law, that it can never be proven by inference drawn from a sample. It depends on the circumstances. Here, there was evidence from which the conclusion could be drawn that the sample was representative, beyond the evidence of the respondent himself. The appellant gave evidence that the content of certain documents was identical

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in each transaction and a defence witness testified as to how contracts and documents for each transaction were prepared from a “template”. Additionally, the appellant did not assert that any fraud evident in the sample transaction was an isolated incident. His position was that there was no fraud, a position that appears consistent with evaluating the matter on the basis of the sample. Finally, the trial judge described the protocol the parties had followed whereby documents could be translated when required. The appellant and various experts and witnesses were fluent in the language of the documents and it was open to them to require translations of any documents that they could use to show the non-representative nature of the sample. There was evidence about some other transactions and, to the extent that it was before the trial judge, it was for him to assess in terms of the sample’s representativeness.

b) The trial judge’s finding of fraud was not solely based on an inference from the sample. The trial judge devoted over 200 paragraphs of his reasons to an analysis of the BVI standing timber model and why it was fraudulent, referring to evidence well beyond the sample. This included: the lack of objective evidence to support the existence of cash flows between the AIs and the Suppliers; the drop in collection of accounts receivable owing by the AIs to nil after the Muddy Waters Report; the failure to locate

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the BVI standing timber after the Muddy Waters Report and even until trial; the expert evidence about critical documents that were missing or deficient such as plantation certificates, maps, Forestry Bureau confirmations, sales contracts and harvesting permits; the inability of the Independent Committee to confirm the existence and operations of Suppliers and AIs; and the appellant's control over supposedly arms-length counterparties. The trial judge made numerous findings of credibility in assessing all of that evidence, which he clearly viewed as a whole.

c) A factual finding of fraud by a trial judge who has weighed large quantities of complex evidence is entitled to deference, absent palpable and overriding error. Such an error must go to the very outcome of the case: *Benhaim v. St. Germain*, 2016 SCC 48, [2016] 2 S.C.R. 352, at paras. 36-38. In light of the findings of the trial judge on the record before him, the alleged errors concerning the sample would not, in any event, rise to the level that would warrant appellate interference.

[157] The appellant also argues that the trial judge erred in allowing the evidence of the respondent, given by affidavit, to remain in the record where it contained opinions that could only be given by an expert. The trial judge was alive to this issue; he ruled in a pre-trial admissibility motion that the respondent's affidavit, where it deposed to matters outside his personal knowledge and

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contained opinions, would not be relied on as evidence but simply as a description of positions that had to be proven by admissible evidence. The trial judge did not rely on any opinions of the respondent that could only be given by an expert. The appellant's objection that the trial judge should have gone on to "redline" out offending portions of the respondent's affidavit elevates form over substance in these circumstances.

[158] I would not give effect to the appellant's arguments about the trial judge's fact-finding.

IV. Conclusion

[159] I would dismiss the appeal. In accordance with the parties' agreement, I would award costs of the appeal to the respondent in the amount of $100,000 inclusive of disbursements and applicable taxes.

Released: "AH" JUN 24, 2019

"B. Zarnett J.A."
"I agree. Alexandra Hoy A.C.J.O."
"I agree. David Brown J.A."

TAB 2

CITATION: Dunsmuir v. Royal Group, Inc., 2017 ONSC 4391
COURT FILE NO.: CV-17-11687-00CL
DATE: 20170720

ONTARIO
SUPERIOR COURT OF JUSTICE
(Commercial List)

BETWEEN:	)	
DOUGLAS DUNSMUIR and RONALD J. GOEGAN	)	
Plaintiffs	)	*Brian H. Greenspan, Richard P. Quance, Jorge Pineda, Michelle M. Biddulph, and Rand Salih*, counsel for the plaintiff Ronald J. Goegan
– and –	)	
ROYAL GROUP, INC.	)	
Defendant	)	*Nigel Campbell, Kent E. Thomson, Doug McLeod, and Steven G. Frankel* counsel for the defendant
	)	**HEARD:** June 12 - 16, 19 - 21, 23, 26 and 28, 2017

F.L. MYERS J.

The Claim and Outcome

[1] The plaintiff Ronald J. Goegan claims damages of approximately $6.6 million for wrongful dismissal. He also claims aggravated and punitive damages.

[2] The plaintiff Douglas Dunsmuir settled his claims with the defendant before trial.

[3] At the time it terminated Mr. Goegan's employment, Royal Group Technologies Limited was a public company. Its common shares were listed and traded on the TSX. The defendant Royal Group, Inc. is the successor to Royal Group.

[4] Royal Group and its predecessor Royal Plastics Limited employed Mr. Goegan from 1990 until 2004. On November 26, 2004, Royal Group terminated Mr. Goegan's employment purportedly for cause. Royal Group gave no notice to Mr. Goegan prior to terminating his employment. It made no payment to Mr. Goegan in lieu of notice. It did not pay him any statutory notice pay or severance pay.

[5] At the time of the termination of his employment Mr. Goegan held the positions of Senior Vice-President and Chief Financial Officer of Royal Group. He was also a member of the board of directors of the company. Mr. Goegan claims that under the implied terms of his oral contract of employment, Royal Group was required to give him 30 months' notice of termination or to pay him the equivalent of what he would have earned had he remained employed by the corporation for the 30 month reasonable notice period.

[6] For the reasons that follow, I find that Royal Group had cause to terminate Mr. Goegan's employment summarily due to his role in the Vaughan West land flip discussed below. After it terminated Mr. Goegan's employment, Royal Group learned additional facts concerning Mr. Goegan's role as one of the senior officers who misappropriated a $4 million corporate asset referred to as the Premdor warrant that is also discussed below. He also participated with the other senior officers involved in a scheme to obtain more favourable income tax treatment for the proceeds of the Premdor warrant. The discovery of Mr. Goegan's serious misconduct by the independent members of the board of directors irreparably severed the relationship of trust and confidence underpinning Mr. Goegan's employment relationship. Therefore, Royal Group was not required to give Mr. Goegan any notice of termination or to pay him notice pay, severance pay, or any amount in lieu of notice. The action is therefore dismissed.

[7] For completeness only, I assess the damages to which Mr. Goegan would have been entitled had Royal Group not had cause to terminate his employment summarily at the amount of $1.61 million. Mr. Goegan would have earned that amount had he been provided with reasonable notice of 21 months to which he would have been entitled in the absence of cause for his dismissal. Prejudgment interest would have been added to the damages in an amount fixed after receipt of submissions from counsel for the parties. I would not have found the defendant liable for aggravated or punitive damages.

Ronald J. Goegan

[8] Mr. Goegan is 56 years old. He obtained his professional Chartered Accountant qualification in 1985. He started his career practicing public accounting for approximately six years. In 1990 Royal Plastics hired Mr. Goegan as Director of Corporate Accounting. In 1994, upon Royal Platics going public, Mr. Goegan's title was changed to Vice-President of Corporate Finance. In 2001, he was promoted to Chief Financial Officer of the company. Later, he also became Senior Vice-President. At the time Royal Group terminated his employment in November, 2004, Mr. Goegan was 43 years old.

Royal Group

[9] Prior to 1994, Royal Plastics was a private company owned principally by Mr. Vic De Zen. It had experienced tremendous growth and was quickly becoming a leading manufacturer or extruder of plastic-based products for use in the construction industry.

[10] By all accounts, Mr. De Zen was a brilliant, charismatic, and autocratic owner of the private company. Under his visionary, entrepreneurial leadership, Royal Group grew substantially and quickly to become a major player in its industry.

[11] In 1994, Mr. De Zen took the company public. The initial public offering raised $185 million from public shareholders. Although the public shareholders' investments represented a substantial proportion of the equity of the corporation, Mr. De Zen held multiple voting shares that gave him over 90% of the votes attached to voting shares.

[12] The public shareholders bought into a corporate structure that was designed to be under the control of Mr. De Zen. The board of directors was to be comprised of a majority of inside directors – directors who were employees of the company. Initially the public offering provided for only two independent or outside directors. Their compliment was later increased to four independent directors. But, at all material times, there were five inside directors cementing Mr. De Zen's control of the board of directors.

[13] The corporate structure was disclosed to public investors in the offering documents. In effect, the public was invited to invest in and share the successes of Mr. De Zen and his team and to share the risk that they might not succeed. There was no doubt that Mr. De Zen was to be in full control of the enterprise as Chair, CEO, and the shareholder with a dominating majority of voting shares.

[14] Internally, there were few controls instituted at Royal Group to oversee management's activities. Despite the wisdom of the adage that "absolute power corrupts absolutely" there were few checks and balances established to protect the $185 million invested by the public from the risks associated with Mr. De Zen's unchecked power. The efficacy of institutional, systemic checks and balances, like the corporate by-laws, the audit committee, the board of directors, and the auditors, all depended on management's willingness to forthrightly disclose truthful and complete facts to the independent overseers. The background law, including the statutory and common law duties owed by directors, officers, and senior managers, looms large in this case as perhaps the only real limits on the risk of abuse of power by Mr. De Zen and those associated with him. If people like Mr. Goegan, who were charged with putting the corporation's interests ahead of their own, failed to fulfil their responsibilities, there was no practical limit on Mr. De Zen's power, including his ability to misappropriate corporate opportunities and assets for himself and his colleagues. And that is what came to pass.

Findings on Credibility

[15] Although many of the basic chronological facts are agreed between the parties and are well documented, it is necessary to assess credibility to deal with Mr. Goegan's efforts to

deflect responsibility away from himself. In his testimony Mr. Goegan consistently underplayed his authority as a very senior employee within the Royal Group. While he did not become the CFO until December 2001, from the date of the IPO in 1994, he was the Vice-President of Corporate Finance. There were many people who held titles as Vice-Presidents spread throughout the multitude of operating subsidiaries in the corporate structure below Royal Plastics. But Mr. Goegan worked in the head office at the apex of the corporate pyramid. While he was initially not part of "Executive Management" for bonus purposes, he was a professional who reported directly to the CFO on financial accounting matters and to Mr. De Zen on real estate acquisitions. While only Mr. De Zen had final decision-making authority on major matters, Mr. Goegan's office was literally located in the hallways of power. That is, he and a very few other senior officers' offices were located on the same hallway as the offices of Mr. De Zen, the CFO Gary Brown, and the General Counsel Douglas Dunsmuir. Mr. Goegan was not a nameless member of the hordes of vice-presidents managing discrete operating subsidiaries in disparate locales. He was an important part of the select group at the very top. He had regular, unfettered access and input to the most senior officers including Mr. De Zen himself on matters within Mr. Goegan's sphere of influence.

[16] Mr. Goegan became quite evasive under questioning several times when confronted with indications of the seniority of his position. Mr. Goegan's evasiveness (that is, his effort to avoid answering direct questions) was particularly noticeable when he was examined on his access to the most senior executives at head office, when he tried to downplay his corporate finance role liaising with the underwriters for the initial public offering, and when he tried to show that others could have discovered the details of the Vaughan West transaction which is discussed below. He also tried to evade and avoid admitting an inconvenient fact involving the recording of the Premdor warrant in the financial records as an asset of Royal Group.

[17] Rather than admitting inconvenient facts, especially when they were as clear as the recording of an asset in a ledger book, Mr. Goegan retreated to word games or evasive deflection. For example, he suggested that conflicts of interest did not raise concerns because they were just "potential conflicts." That was a distinction without a difference. Whether potential or actual, the transactions at issue were tinged with conflict that required investigation and resolution. It is the degree of Mr. Goegan's participation and investigation (or lack thereof) that is in issue. Classifying the transactions as merely "potential" conflicts of interest was sophistry. He also suggested at one point that his reference to "Royal" in a memo was an informal reference to both Royal and Mr. De Zen when the whole purpose of the memo was to differentiate between the two so as to show that only De Zen and not Royal Group had bought the Vaughan West land. Mr. Goegan is an intelligent man who skillfully and carefully used language to try to advance his position. A significant degree of evasion was apparent in those efforts and negatively affected my view of the credibility of his evidence.

[18] Mr. Goegan also recalled extra facts when he perceived them as helpful. For example, he denied knowing that Mr. Blakely was a senior real estate professional at Royal LePage because he had only dealt with Mr. Blakely once. But then when pushed to support his evidence that the market place knew that Mr. De Zen was a major land owner in Vaughan, he

testified that Mr. Blakely knew that Mr. Goegan and Mr. De Zen were continuously soliciting the market place looking for land deals in Vaughan. How could he know that if he only dealt with Mr. Blakely once? Similarly, Mr. Goegan testified in his affidavit that when Mr. Blakely approached him to discuss the possible sale of the Vaughan West land to Royal Group, it was Mr. Goegan who first suggested that Mr. De Zen might want to buy the land in his personal capacity. Mr. Goegan changed his story at trial. When Mr. Goegan testified in chief he added the fact that when Mr. Blakely called Mr. Goegan, Mr. Blakeley offered the land to both Royal Group and to Mr. De Zen. Mr. Blakely denied this squarely and his testimony was not undermined in cross-examination on the point. Mr. Goegan, by contrast, was successfully impeached on this important new fact that changed his prior sworn evidence.

[19] Mr. Goegan's testimony changed and he was impeached on the content of his conversation with Mr. Brown in which Mr. Brown allegedly told Mr. Goegan to ensure that Mr. De Zen obtained an appraisal in relation to his flip of the Vaughan West land to Royal Group. Mr. Goegan purported to recall facts from a 20 year old, undocumented conversation that he did not recall on being examined for discovery three years ago. Mr. Goegan was impeached successfully on his purported recovered memory.

[20] Mr. Goegan's evidence concerning basic ethical concepts also affects my assessment of his credibility. Mr. Goegan testified that he did not know that it was improper to back-date documents to make it appear that transactions occurred at an earlier time so as to obtain preferential income tax treatment. His evidence concerning back-dating documents was inherently incredible coming from an intelligent, experienced, senior Chartered Accountant who was the Chief Financial Officer of a significant public corporation. A Chartered Accountant and CFO of a public corporation who says that he does not know that it is improper to back-date documents to avoid tax is either engaged in deception or his basic ethical gyroscope is so far off its axis as to undermine the credibility and reliability of his observational and analytical abilities.[1]

[21] By contrast, Messrs. Ronald Slaght, Gregory Sorbara, and Trevor Blakely gave evidence for the defendant. They each gave their evidence in a straightforward manner. They admitted frailties of memory appropriately. They admitted mistakes. Both Mr. Slaght and Mr. Sorbara volunteered forthrightly that they could have done more as independent members of the board of directors to oversee management. Any impeachments were minor and did not, in my view, disclose important changes in their sworn testimony. Mr. Slaght became indignant when confronted with questions that suggested that unethical conduct was acceptable at Royal Group. I viewed his indignation as holding a strict ethical line rather than defensiveness or belligerence.

[1] I am not ignoring that the Premdor warrant back-dating scheme raised more concerns than back-dating alone. I will deal with the amplification of my concerns about the credibility of the participants in the Premdor warrant transaction below.

In my view, in the circumstances (especially responding to a suggestion in cross-examination that management was free to take money from the public corporation as long as they took less than the $60 million management approval limit) Mr Slaght's indignation and incredulousness were entirely appropriate.

[22] It follows that where the evidence of Mr. Goegan conflicts with the evidence of Messrs. Slaght, Sorbara, or Blakely, I prefer the evidence of the other three over that of Mr. Goegan.

[23] Mr. James Sardo also gave evidence for the defendant. He had very little independent recollection of events from 2004 when he became involved. Nothing turns on his evidence.

[24] Finally, Douglas Dunsmuir gave evidence largely supporting Mr. Goegan's case. Mr. Dunsmuir testified that as the General Counsel of Royal Group, he delegated to external counsel *to the exclusion of himself* his duties to ensure that Royal Group complied with the law. There was no documentary support for that position. No law firm was shown to have undertaken the mandate of General Counsel to ensure internal compliance at Royal Group. There was no public disclosure of this supposed shedding of responsibility by the corporation's senior legal officer.

[25] Mr. Dunsmuir testified that as long as a related party transaction fell within management's $60 million approval limit and the corporation's auditor did not classify it as material for financial reporting purposes, then he did not believe that there had to be disclosure or approval of the transaction sought from the board of directors despite the provisions of the corporate by-laws, the *Canada Business Corporations Act*, and the common law. He put the lie to his own testimony when his discussed his response to Mr. De Zen upon being told of the Vaughan West land flip. He testified that he told Mr. De Zen that the transaction should not be carried out with senior officers of Royal Group making a profit and that it was a material transaction that needed board approval even though it fell within management's $60 million approval limit. He then did nothing to ensure that the transaction was properly disclosed and approved by the board of directors. Instead he purportedly accepted CFO Brown's assurance that the auditors found the transaction immaterial and allowed this to supplant his legal advice that disclosure and board approval of the transaction were required.

[26] Mr. Dunsmuir and Mr. Brown both took secret profits on the Vaughan West land flip of about $200,000 each at the expense of Royal Group. Mr. Dunsmuir was in a conflict of interest. He knew the legal duties that applied to him and his colleagues and he violated them for personal profit. He ignored the rights of the corporation and through it, the shareholders and stakeholders – the ultimate beneficiaries whom he was duty-bound to protect selflessly. He did the same with the Premdor warrant discussed below on which he made a profit of almost $510,000 at the expense of the corporation. Moreover, on that transaction he also participated in the tax back-dating scheme mentioned above. Mr. Dunsmuir's infidelity personally and as a lawyer undermines his credibility as a witness. I reject Mr. Dunsmuir's evidence as self-serving

and untrustworthy generally and specifically when it conflicts with the testimony of Messrs. Slaght, Sorbara, or Blakely.

Board Approval of Related Party Transactions

[27] Prior to the 1994 initial public offering Mr. De Zen held substantial amounts of land for future development purposes. The land was held in Royal Group or, more often, in separate corporate entities owned by Mr. De Zen and several of his colleagues (some of whom were also senior officers of Royal Group).

[28] With the input of the underwriters, Mr. De Zen decided that his inventory of raw, undeveloped land that did not produce a positive cash flow would be excluded from the IPO. Mr. Goegan was involved in moving raw land or the corporations in which it was held out of Royal Group to ready it for the IPO. After the IPO, Mr. De Zen and his colleagues continued to invest in the development of their land independent of their positions with Royal Group. For a monthly fee, Royal Group staff did administrative and accounting work for Mr. De Zen's private investments and the corporate vehicles through which they were owned.

[29] Mr. Goegan testified that after the IPO it was expected that there would be transactions between Mr. De Zen in his personal capacity and the public corporation.

[30] By-law No. 1 was adopted by the Royal Group as part of the implementation of its IPO. Section 4.18 of By-law No. 1 provides:

> **CONFLICT OF INTEREST** – A director or officer who is a party to, or who is a director or officer of, or has a material interest in any person who is a party to, a material contract or proposed material contract with the Corporation shall disclose the nature and extent of his or her interest at the time and in the manner provided by the [*CBCA*]. Any such contract or proposed contract shall be referred to the board or shareholders for approval ***even if such contract is one that in the ordinary course of the Corporation's business would not require approval by the board or the shareholders***. Such a director shall not vote on any resolution to approve the same except as provided by the Act. [Emphasis added.]

[31] If Mr. De Zen proposed to do business with Royal Group, under s. 4.18 he was required to disclose his interests to the board of directors and obtain its approval.

[32] Section 6.12 of the by-law requires officers to disclose their interests as well under section 4.18. Section 6.01 of the by-law defines officers to include vice-presidents of the corporation.

[33] It was understood within Royal Group that management had general authority to enter into contracts with a value of less than $60 million without board of directors' approval. Moreover, for the purposes of financial statement presentation, contracts of less than $60 million and perhaps more, were considered immaterial by the auditors. However, section 4.18 requires board or shareholder approval of *material* contracts in which a director or officer has an interest even where the contract would not otherwise require board approval. The use of the word "material" in s. 4.18 is unfortunate because it carries a number of different meanings in different contexts. In just this paragraph the word "material" or, conversely, "immaterial" could have three different meanings. Management referred to contracts that fell under its approval limit of $60 million as "immaterial." The auditors and accountants referred to transactions that were small enough to ignore for financial statement disclosure purposes as "immaterial." Finally, section 4.18 refers to "material contracts" that need board of directors or shareholder approval even if not otherwise required.

[34] There is no reason for the word "material" in s. 4.18 to mean the same thing as management's colloquial use of the word as a synonym for its approval limit. Nor need it mean the same thing as a term of art used in the accounting profession. Were it otherwise the section would be superfluous. If "material" in s. 4.18 exempts from disclosure contracts that are immaterial because management does not need approval to enter into them or because the auditors do not need to disclose them, then the words emphasized in s. 4.18 above, that require board approval even where it is not otherwise required, would be meaningless. That is, if a contract is not material under s. 4.18 just because it is under management's $60 million approval limit or because the auditors do not require it to be disclosed in financial statements, then section 4.18 would not require approval of that contract for the very reason that the approval was not otherwise required. That is the opposite of what it says.

[35] The by-law refers to and incorporates s. 120 of the CBCA that was then in force that also applies to "material contracts." The by-law should be interpreted to fit with the statute in accordance with modern, remedial, purposive approach to interpretation. The interpretation of the statute is discussed in Welling, *Corporate Law in Canada: The Governing Principles*, 2d ed. (Vancouver: Butterworths, 1991) at p. 452-453:

> In the context of conflict of interest contracts, the meaning of "material contract" and "material interest" is conditioned by the purpose behind the section. The purpose is to identify those negotiations in which a corporate manager's ability to bargain effectively on behalf of the corporation may be inhibited by some interest he has in the other side…..Whether to participate in a proposed contract is a corporate decision and the corporation is entitled to full disclosure from its fiduciaries of all facts that might affect that decision.

[36] The statute, as it stood at the time, provided a mechanism for a corporation to approve contracts with interested directors and officers. The first step in the process is the mandatory disclosure to the board of directors of the conflicting interests of the fiduciaries involved:

> 120. (1) A director or officer of a corporation who
>
> > (a) is a party to a material contract or proposed material contract with the corporation, or
> >
> > (b) is a director or an officer of or has a material interest in any person who is a party to a material contract or proposed material contract with the corporation,
>
> shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his interest. R.S.C. 1985, c. C-44.

[37] The section requires directors and officers to make formal, written disclosure to the board of directors of their personal interests in material contracts. The section is intended to apply to contracts in which the interests of the corporation are in need of protection from the risk

of compromise by the competing personal interest of an officer or director who, as a fiduciary, is required to be protecting selflessly the interests of the corporation. In my view, adopting a purposive reading leads readily to the conclusion that, at minimum, a contract is material for the purposes of s. 4.18 of the by-law and s. 120 of the statute where an officer or director who is involved in the approval of the contract on behalf of the corporation has a non-trivial personal interest in its subject matter. *Exide Canada Inc. v. Hilts*, 2005 CarswellOnt 5916, [2005] O.J. No. 4685, at paras. 11 and 12 (ON SC).

[38] While the word "material" can refer to a measure of relative value or a measure of relative importance in a context, at the very least, where a director or officer is charged with considering a contract selflessly on behalf of a corporation, the fact that she has a personal interest in the contract will always be material to the board of directors and investors. Regardless of whether the director or officer is believed to be an entrepreneurial genius or a person who is beyond ethical reproach, even the appearance of conflict of interest calls out for protection by disclosure and independent approval. The common law and common sense recognize that conflict of interest is an insidious force that can deprive even the best of us of balanced, independent judgment. Peoples' capacity to be convinced of the righteousness of their own conduct by the lure of lucre has no known limits. The facts of this case demonstrate the wisdom and prudence of strict rules for independent oversight and review of decisions taken in conflict of interest.

[39] Moreover, the fact that management's approval limit of $60 million was not intended to guide the legal determination of when interested director and officer contracts required board approval was confirmed in Royal Group's public disclosure documents. For example, in the Management Proxy Circular for its 1996 annual general meeting, the company wrote:

> ***In addition to those matters which must by law be approved by the Board*,** Management is also required to seek Board approval for any disposition or expenditure in excess of $60,000,000. Management is also required to consult with the Board before entering into any venture which is outside of the Corporation's existing businesses. [Emphases added]

[40] Of course management's disclosure does not determine the law. This disclosure plays no part in my interpretation of the by-law and the statute. But, it does confirm that the legal interpretation is consistent with what management understood to be the case. In contrast to Mr. Dunsmuir's purported retroactive abdication of his legal responsibilities and Mr. Goegan's efforts now to take refuge behind management's $60 million approval limit, management understood at the time that the issue of conflict of interest was separate and distinct from its monetary approval limit. In fact and in law therefore, management's approval limit cannot be conflated with other legal requirements to seek board approval for related party transactions under s. 4.18 of the by-law, s. 120 of the *CBCA*, or when management proposed to act outside of the ordinary course of business.

[41] Although the requirements for board of directors' approval of interested director and officer contracts existed, they were not followed at Royal Group during the time frame involved in this action. That does not make undisclosed transactions lawful. However, it is relevant to the issue of whether Mr. Goegan's conduct was consistent with the standards applied to employees' duties by the board of directors and management at Royal Group generally at the relevant time. This will be part of the contextual assessment of whether Mr. Goegan's conduct amounted to cause for his summary dismissal.

The Vaughan West Land Flip

[42] In November, 1997, Mr. Goegan received a telephone call from Trevor Blakely, a senior real estate salesman at Royal LePage. Mr. Blakely told Mr. Goegan that H&R Developments owned and wanted to sell 142 acres of land at the southwest corner of Highways 7 and 27 in Woodbridge in the City of Vaughan. H&R's land was located directly across the street from Royal Group's head office. Mr. Blakely told Mr. Goegan that H&R was a motivated seller that preferred to engage in a private transaction rather than listing the property publicly for sale. He asked if Royal Group might be interested.

[43] Mr. Goegan knew that Mr. De Zen and his colleagues were major land owners in Vaughan. They owned substantial land north of Highway 7 that was already under development. He told Mr. Blakely that while Royal Group was likely not interested in a parcel of that size, it might be of interest to Mr. De Zen.

[44] At the time, Royal Group was expanding internationally but its expansion plans did not include major development in Vaughan. Nevertheless, Mr. Goegan believed that the opportunity to buy the Vaughan West land might well be a good opportunity for Royal Group especially because the land may be available at a good price. Mr. Goegan approached Mr. De Zen and advised him of the approach made by Mr. Blakeley. Mr. De Zen initially responded that Royal Group was not interested.

[45] The offer of the Vaughan West lands was a corporate opportunity of Royal Group. Mr. Goegan confirmed that he was the public face of Royal Group in real estate matters. Mr. Blakely brought the transaction to Mr. Goegan for Royal Group (as attested to by Mr Blakely and by Mr. Goegan initially in his affidavit). Mr. Goegan's affidavit is also clear that Mr. De Zen told him that "Royal Group was not interested in the lands."

[46] Mr. Blakely followed up with Mr. Goegan in early December. Mr. Goegan approached Mr. De Zen again during a break in a board of director's meeting on December 3, 1997. Mr. Brehn, an independent director, was near enough to hear or to be part of the conversation. Mr. Goegan reminded Mr. De Zen of the opportunity. Mr. De Zen upbraided Mr. Goegan in front of Mr. Brehn, reminding him that undeveloped land that did not have positive cash flow had been excluded from the IPO and was not of interest to Royal Group. However, Mr. Goegan continued to believe that the land was or ought to have been of interest to Royal Group. Mr. Goegan persisted. He made the point to Mr. De Zen that the land might not be available later

should Royal subsequently want it. He says that Mr. De Zen then mused to Mr. Brehn that perhaps he might buy it himself so it would be available to Royal Group later if needed.

[47] Mr. Goegan advised Mr. Blakely that Mr. De Zen might be interested in the land. Mr. Goegan stayed in contact with Mr. Blakely through December and into January 1998.

[48] On January 12, 1998, Ernest Racco of RenTex Realty contacted Mr. Goegan. Mr. Racco was known to Mr. Goegan as a real estate advisor who had acted for Mr. De Zen and his colleagues on land transactions previously. Mr. Racco advised Mr. Goegan that Mr. Bordin, one of Mr. De Zen’s colleagues, had instructed him to prepare an offer to purchase the Vaughan West land. Mr. De Zen was behind the purchase. Mr. De Zen asked Mr. Goegan to share with Mr. Racco his discussions with Mr. Blakeley and to assist Mr. Racco with the negotiation of the purchase price. Mr. Goegan spoke to Mr. Racco and then took part in the ongoing negotiations with the vendor to buy the land for Mr. De Zen and his colleagues.

[49] By agreement of purchase and sale dated January 22, 1998, Mr. Bordin in trust agreed to buy the Vaughan West land from an H&R affiliate for approximately $20.5 million.

[50] Mr. Goegan confirmed that Mr. De Zen would have others like Mr. Bordin sign such agreements so as to disguise his involvement. Mr. De Zen feared that vendors might seek a higher price if they knew that he was involved in light of his major landholdings in the vicinity.

[51] Mr. Goegan remained involved in the transaction as it moved toward closing. He was copied on the environmental report on the land. He put in motion the accounting for the transaction and advised his tax colleague Lu Galasso of the amounts that Mr. De Zen and his colleagues would be required to pay on the closing of the transaction on March 31, 1998.

[52] In late March, Royal LePage sued Royal Group, Mr. Goegan, and others claiming that it was entitled to commission on the deal it brought to Royal Group. Royal Group retained Ronald Slaght of the Lenczner Slaght law firm to act for it and its employees. Mr. Slaght was also an independent member of the board of directors of Royal Group. He had held that position since the IPO in 1994.

[53] Mr. Goegan prepared a memo for Mr. Slaght that formed the basis of a draft affidavit that Mr. Slaght prepared. The essence of the story advanced in Mr Goegan’s memo, that Mr. Slaght carried into the draft affidavit, was that the purchaser of the property was not Royal Group but a corporation in which Mr. De Zen held less than 50% of the shares and therefore was not an affiliate of Royal Group. Royal Group had no interest in the transaction that could make it liable for any tort or for the broker’s commission.

[54] The draft affidavit prepared by Mr. Slaght stated that Royal Group had no interest in the land and played no part in the transaction. By that time however, Mr. Goegan had learned that there was internal discussion under way at Royal Group of the possibility of the land being purchased by Royal Group from Mr. De Zen and his colleagues. He says that he mentioned this to Mr. Slaght in their one and only telephone call to discuss the draft affidavit. Mr. Slaght denied

knowing that Royal Group was at all involved with this transaction as it is contrary to the defence being put forward in the memo and the draft affidavit. I accept Mr. Slaght's evidence rather than Mr. Goegan's evidence on this point.

[55] Mr. Goegan says that he did not then know the price proposed for the sale to Royal Group. He was just concerned as to the manner of disclosure of the proposed possibility of a sale to Royal Group in his draft affidavit. He suggested adding the word "possible" so as to have him say in the affidavit that Royal Group had no involvement in the "possible sale" to Mr. Bordin. While the addition of that word might make the sale to Mr. Bordin in trust seem a bit less certain, it did nothing to suggest that there was any sale contemplated to Royal Group. Mr. Goegan says he remained concerned that the draft did not properly disclose the possibility of a sale to Royal Group. Yet he never called Mr. Slaght back to ensure that this disclosure was made in the affidavit. Neither did he call Mr. Slaght back when he learned the price and terms proposed or ever.

[56] The affidavit was never finalized as the litigation was quickly settled by other parties. Mr. Slaght spent only a few hours over a few days on the entire retainer. While it certainly shows that he knew that Mr. De Zen had real estate interests outside of Royal Group and that he was buying the land at that time, nothing in the Royal LePage litigation shows any knowledge by Mr. Slaght of the flip that ensued.

[57] It turns out that a few days prior to closing, Mr. De Zen advised Mr. Goegan that Messrs. Brown and Dunsmuir were part of the group participating with him in the purchase of the Vaughan West land. This did not surprise Mr. Goegan as he understood that the CFO and General Counsel frequently held 3% each in Mr. De Zen's private investments.

[58] Mr. Goegan learned that upon Mr. De Zen's recent return from a trip to Italy, Mr. De Zen decided that instead of Royal Group building manufacturing facilities abroad, it would buy the Vaughan West land and build a major manufacturing and warehousing hub across the street from head office. Mr. Dunsmuir testified that he thought that this was a not a good idea. It exposed the company to higher transportation costs, higher labour costs, and foreign currency risk. However, Mr. De Zen made up his mind and his word carried the day. He also advised that his colleagues in the investment did not want to give the land to Royal Group. Mr. De Zen apparently claimed that he had to stay neutral as between Royal Group and his partners. He decided that on the closing of their purchase, he and his colleagues would flip the Vaughan West land to a subsidiary of Royal Group for approximately $27 million. There was no negotiation of the price and no one independent of Mr. De Zen and his selling group acting on the Royal Group side of that transaction.

[59] The initial purchase transaction and the flip to Royal Group were both scheduled to close on the same day. The corporate vehicle used by Mr. De Zen and his colleagues (including Messrs. Brown and Dunsmuir) would buy the land from H&R for about $20.5 million and then Royal Group would buy the shares of the purchaser company from Mr. De Zen and his colleagues that day for about $27 million.[2]

[60] Mr. De Zen made a personal profit of around $3 million on the flip. Messrs. Brown and Dunsmuir each cleared a profit of approximately $200,000 on the flip.

[61] Mr. Goegan objected to the characterization of the transactions as a flip. In a lengthy soliloquy he provided much hearsay as to his understanding of why the land gained $6.5 million or about one-third in value in the two months between the date of the initial agreement of purchase and sale in January, 1998 and the date of closing at the end of March, 1998. He opined that advances made in zoning and in learning that there were no significant environmental defects with the site accounted for the tremendous growth in value over those two months. There was no admissible evidence presented of any change in the zoning status of the land over the two month period. The land was already zoned for industrial use in the Official Plan so that only minor zoning amendments were required in any event. Mr. Dunsmuir was not aware of any zoning changes that occurred in the period. Mr. Blakely testified that the land was raw farm land. As it had not previously been used for industrial purposes, no significant environmental concerns were expected. If it had some minor damage (as it did in fact) that could only impair the price. He gave common sense evidence that while environmental damage might decrease the price, the absence of damage to raw land would not be expected to increase the price. When investigating the transaction later, Kroll did not seek an independent appraisal of the land as at March 31, 1998 because it was content that the price agreed upon by H&R Developments and Mr. De Zen and his colleagues in January of that year provided a real, arm’s length market test that evidenced the fair market value of the site.

[62] While prices were certainly on the rise generally in Vaughan during that timeframe, the plaintiff called no independent evidence to establish the fairness of the price charged to Royal Group for the land by Mr. De Zen and his colleagues. I infer that he would have done so if he could have and that the land was worth only what Mr. De Zen and his colleagues paid for it or a trifle more at the time that they flipped it to the public corporation for a $6.5 million profit.

[63] Mr. Goegan’s essential justification for the transaction was his view that as long as a sale from corporate officers to the corporation is priced at fair market value and occurs in the ordinary course of business, then it is only a potential conflict rather than being an actual conflict of interest. As I discussed above, this is not a correct view of the requirements for the approval of

[2] For clarity and simplicity, I ignore the fact that the shares were actually bought by a wholly-owned subsidiary of Royal Group. Nothing turns on that fact.

related party transactions. Neither is it correct in law as discussed below. In any event, Mr. Goegan says that he was instructed by Mr. Brown to advise Mr. De Zen that he needed to obtain an appraisal to support the value of the purchase price paid by Royal Group. Mr. Goegan says he told this to Mr. De Zen. Mr. Brown also said that he was going to get a second appraisal from Mr. Racco.

[64] Mr. Goegan claims that Mr. De Zen told him that he had an appraisal at $165,000 per acre that exceeded the price paid by Royal Group. He says that Mr. Brown told him that he had spoken to the company's auditors and they confirmed that the transaction was immaterial and did not have to be disclosed. And that was fine with Mr. Goegan. He oversaw the arrangements for payments and accounting for the various transactions.

[65] As the most senior manager of the company engaged in negotiating and closing the transactions who was not profiting personally on the flip, Mr Goegan did no due diligence to confirm that the property was sold at fair market value or in the ordinary course as he believed to be required. He did not see any appraisal. In fact, years later Lu Galasso produced a letter from a real estate firm that gave a one-line statement of value that purported to support the price of the flip. Interestingly, in 2000 Mr. Galasso had been asked to provide evidence to support the price and he advised that Mr. Racco had opined that the price was fair. He did not mention the letter that he produced at a later date.

[66] Actually Mr. Galasso produced two versions of the same letter setting out the same value for the land. The first one was dated in June, 1997, some five months before Mr. Blakely first offered the property to Mr Goegan. It purports to value the land as at March 31, 1998, some nine months into the future. The second version was dated at the correct March 31, 1998 date. It is obvious that the first draft was a back-dated document that was back-dated too far and exposed on its face the illegitimacy of the purported retroactive papering of a valuation effort. The letter did not purport to be an appraisal or to contain any rationale for the value that the author ascribed to the land. In relying on the letter, Mr. Goegan denied knowing the difference between an appraisal and a one-line letter stating a value. This was yet another obvious understatement that was inconsistent with his experience, knowledge, and insight both as a CA and as a person engaged in significant real estate transactions. There were no comparables disclosed in the letter nor is any valuation methodology discussed. Subsequent efforts to locate the author of the letter failed. The letter is neither credible nor admissible as a valuation.

[67] Mr. Goegan also confirmed that the purchase of this real estate was by far the largest land purchase ever made by Royal Group. It was as much as three times larger than the next biggest purchase made by the company to that time. Mr. Goegan had been upbraided by Mr. De Zen in December for having had the temerity to even suggest that Royal Group might be interested in buying raw, undeveloped land that did not generate positive cash flow. To his knowledge then, this transaction was not carried out in the ordinary course of Royal Group's business.

[68] In all, despite Mr. Goegan saying that related party transactions were not conflicts of interest if priced at fair market value and conducted in the ordinary course of business, he saw no evidence of either condition being met. Neither did he look for any. Nor did he tell anyone who might have had oversight responsibility over Mr. De Zen of the absence of evidence needed to clear the conflicts under his test. He also did nothing to ensure compliance with By-law No.1 or the *CBCA* or to bring the flip and secret profit to the attention of someone who could do so.

[69] To summarize my findings on Mr. Goegan's involvement in the Vaughan West land flip:

a. He received the opportunity on behalf of Royal Group as the public face of Royal Group in real estate acquisitions;

b. He suggested that the opportunity be directed to Mr. De Zen and senior management;

c. He shared with Mr. Racco on behalf of Mr. De Zen and his colleagues commercial insight and information that he had gleaned in relation to Royal Group's opportunity;

d. He participated in the final negotiation to buy the land from H&R on behalf of Mr. De Zen and his colleagues;

e. He learned that on the closing of the purchase, Mr. De Zen and his colleagues were flipping the land to Royal Group for an undisclosed personal profit of approximately $6.5 million at Royal Group's expense;

f. He was the senior-most person at Royal Group with significant involvement in the transaction who was not profiting personally on it;

g. He believed that the transaction was only a potential conflict of interest and that the conflict could be cured if the land was sold to Royal Group for fair market value in the ordinary course of business;

h. He took the word of officers whom he knew to be making substantial personal profits on the transaction that an appraisal had been obtained and the auditors had said that the transaction was immaterial. He did no due diligence and did nothing as a careful accountant to paper the file;

i. He knew that the transaction was not in the ordinary course of Royal Group's business and therefore did not meet even his own test for a "potential" conflict as opposed to a real conflict of interest;

j. He helped the junior in-house counsel close the deals. He oversaw the banking, the movements of money, and the financial reporting;

k. He had been in touch with Mr. Slaght, an independent director, just days before closing to deal with the Royal LePage litigation and he knew how to get in touch with Mr. Slaght. He did not tell Mr. Slaght that the land was being sold by the insiders to Royal Group on the day of closing of the initial purchase for a $6.5 million profit; and

l. He did not take any step to even try to ensure that the transaction was approved by the board of directors as required by the by-laws and the *CBCA*. He told no one with independent oversight responsibilities, like the auditors or an independent director, and he did nothing to ensure that the deal was properly disclosed and approved by anyone on behalf of the corporation who was not making a secret, personal profit.

[70] Mr. Goegan notes that the financial details of both transactions were set out clearly in the books and records of Royal Group and Mr. De Zen's company that flipped the land. That is true. Although someone looking just at Royal Group's books who did not have access to the books of Mr. De Zen's company would not see the price paid to H&R for the land and so would not see the profit being made. Once retained to investigate related party transactions, Kroll was able to piece together the story quite readily. It was not hidden in the sense that information was available in the books and records of the various companies if one went to look for it. In any event, as I will discuss below in dealing with the law, the fact that a trail of breadcrumbs was left is irrelevant. The duty of disclosure is a positive one and an exacting one. It is not enough to say that the auditors could have found it. Mr. Montesanti gave evidence that the Royal Group side of the transaction was provided to the auditors. Yet management's representation letter to the auditors for the relevant year contains management's positive representation that there were no related party transactions. Despite Mr. Greenspan's suggestion in cross-examination that the auditors took the lead in drafting management representation letters, the representations in the letter are those of management. In this case, management's representation was untrue. It can hardly be said to be disclosure to the auditors to put them on notice to go look at the transaction to discover the flip.

[71] Similarly, Mr. Goegan argues that when the board was later told that land had been bought (with no disclosure of the details) and when Mr. Slaght later saw buildings being built across the street, he ought to have remembered that during the few days of litigation with Royal LePage he had been told that De Zen was buying the land and not Royal Group. Mr. Slaght should have pieced together that the land bought by De Zen must have been transferred to Royal Group and he could have asked to see if there was anything untoward in the related party transaction.

[72] Mr. Slaght testified that it did not click with him that the land that was the subject of the litigation on which he spent only a few hours was the same land as was bought and being built on by Royal Group. He was cross-examined on this topic with no indents made in his testimony. Once again, the argument is ultimately irrelevant. The duty to disclose is not met by hoping that an independent director pieces together clues.

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[73] There is no doubt that in 1998 Royal Group did not have a proper internal control system in place for reporting on and assessing related party transactions. No one reported related party transactions to the board of directors at Royal Group until Mr. Goegan instituted reporting processes after he became CFO. Thirteen transactions were later identified and studied by Kroll when a special committee of the board was appointed to look at related party transactions. Twelve of the 13 were found to have been transfers at fair market value. Whether Mr. De Zen or other insiders made a profit on those transactions that should have been disgorged is not in evidence. The Vaughan West land flip is the one related party land deal that was carried out far in excess of fair market value where it can be readily found that Royal Group suffered prejudice at the hands of its senior officers on the transaction. While the law may not differentiate between breaches of duty that cause actual loss and those that do not in this context, it is nonetheless a fact that the Vaughan West land was flipped to the company by Mr. De Zen and his colleagues for some $6.5 million more than they had paid for it that day.

[74] The company's lack of internal controls is relied upon by Mr. Goegan as part of the contextual background that he says prevents any breaches of his duties from severing his employment relationship and amounting to cause for dismissal.

[75] Mr. Goegan also notes that in 2004 when Royal Group came under investigation by the Ontario Securities Commission and the RCMP, the former listed the "Woodbridge expansion" as an example of a related party transaction in which it was interested. That is, the OSC apparently knew that Mr. De Zen had sold the Vaughan West land (referred to by the OSC as Woodbridge) to Royal Group. Moreover, independent market analysts have subsequently advised that they knew or believed that to be the case too. Mr. Goegan argues that the board must have known that the land was sold by Mr. De Zen to Royal Group. Mr. Slaght and Mr. Sorbara say that they did not know. Certainly no one told them. Even had they pieced it together (which they did not) they were not told that Mr. De Zen and his colleagues, including the CFO and General Counsel of the corporation, took a $6.5 million secret profit on the way through. The irrelevancy of this finger pointing and deflection of responsibility will become clear in dealing with the law on the duty of disclosure below. It is no defence to a mandatory disclosure obligation to say that the people to whom a duty to disclose is owed ought to have figured it out for themselves. That just negates the duty itself.

The Premdor Warrant

[76] At the time of the IPO, Royal Group approved a bonus plan for senior executives. The plan was linked to corporate performance. The goal was to incent Mr. De Zen and his team to continue their entrepreneurship by giving them substantial stakes in the outcome. Accordingly the bonus plan provided for senior managers to share in 2% of corporate EBITDA. In addition, a full further 2% of EBITDA was allocable to Executive Management, i.e. the company's most senior managers. Mr. Goegan qualified for inclusion in the manager's 2% throughout. He only qualified for inclusion in the additional 2% allocated to Executive Management once he became CFO in December, 2001.

[77] Section 6 of the bonus plan provided that the maximum bonus that may be paid to management was 4% of EBITDA. Section 11 of the bonus plan provided that any amendment of the bonus plan required shareholder approval. Accordingly, neither the board of directors nor Mr. De Zen had any authority to deviate from the 2 + 2 formula in granting management bonuses.

[78] Over time bonuses were determined by Mr. De Zen. He decided which employees fit into each pool of 2% of EBITDA and the amounts each employee received. At times the 2% limits were exceeded. In the first several years, the aggregate 4% limit was never or only rarely exceeded however. The board learned of the bonus allocation to Executive Management in the approval process for annual Management Proxy Circulars. Messrs. Sorbara and Slaght did not do the 2% EBITDA calculations themselves to double check management.

[79] In late 1999 and early 2000, Mr. De Zen negotiated a joint venture agreement between Royal Group and a public company called Premdor. The deal was structured as a sale of a Royal Group subsidiary to Premdor under an agreement of purchase and sale. A separate cooperation agreement was entered into to describe the joint venture.

[80] Mr. Goegan was not involved in either the negotiation or finalization of the agreements.

[81] The hearsay evidence presented at trial is that Mr. De Zen told Premdor that since Royal Group’s employees who will work on the joint venture would be entitled to options from Royal Group under the terms of their employment, Premdor too should offer options to those employees.

[82] Premdor had legal advice that they could not offer their securities to joint venture employees without issuing a prospectus and it was not willing to do so.

[83] Premdor and Royal Group did agree that, in addition to the cash and shares that Premdor offered to pay for Royal Group’s subsidiary, Premdor would include in the agreement of purchase and sale, as part of the purchase price that it was paying, a share warrant that entitled Royal Group to purchase 200,000 more Premdor shares from treasury at a strike price of $13.25.

[84] At the time, the share price of Premdor shares on the stock exchange was less than the $13.25 strike price in the warrant. The warrant was therefore "out of the money." It only represented a possible future source of value if the price of Premdor shares climbed and exceeded $13.25.

[85] Messrs. Dunsmuir and Goegan say that it was always understood that the warrant was not really part of the purchase price paid for Royal Group's subsidiary. Cash and shares of Premdor were paid by Premdor for the Royal Group subsidiary in the agreement of purchase and sale. They say that the warrant was always intended by Premdor and Royal Group to be held in trust for senior executives involved in the joint venture in lieu of a Premdor contribution to an employee stock option plan.

[86] This story lacks credibility. There is no indication of why or how a warrant was to be used as a substitution for stock options. The agreement of purchase and sale makes no distinction between the warrant and the other forms of consideration paid by Premdor for the Royal Group subsidiary. It simply sets out the cash, the shares, and the warrant as the listed elements making up the purchase price to be paid by Premdor to Royal Group.

[87] The books and records of Royal Group disclose the warrant as a Royal Group asset with no indication of it being held in trust for employees. There was no disclosure of any such trust to the board of directors of Royal Group. Moreover, there is no indication of why Premdor would engage in a structural subterfuge that violated securities law by indirectly issuing securities to people who did not qualify for a prospectus exemption.

[88] The warrant itself provided that it was not transferable. That undermines directly the story that it was always understood that the warrant was to be owned and transferred to employees of Royal Group.

[89] I find as a fact that the Premdor warrant was and always remained the property of Royal Group as part of the consideration paid to it for the sale of its subsidiary. The whole trust tale was a creation of Messrs. Galasso and Goegan for their tax scheme as discussed below.

[90] Despite the terms of the corporate bonus plan to the contrary, Mr. Goegan says that Mr. De Zen had the unilateral authority to direct bonuses to employees apart from participation in the EBITDA pools. As such, Mr. De Zen directed that 3% of the warrant would be held for Mr. Brown and a further 3% for Mr. Dunsmuir. Mr. Goegan argued that the warrant was held in trust by Mr. De Zen rather than Royal Group so as to enable Mr. De Zen to make that decision. The warrant was legally registered to Royal Group so that Mr. Goegan's effort to paint Mr. De Zen as the "trustee" must fail. However, it is consistent with Mr. De Zen's near absolute authority, that if the warrant was actually held in trust by Royal Group, that he would exercise Royal Group's duties and powers in that regard.

[91] Fast forward 18 months to August, 2001. The Premdor warrant remained under water. Mr. Brown apparently announced that he would be retiring from Royal Group upon

completion of the fiscal year reporting the following December. Mr. Goegan testified that Mr. De Zen told him that he was being promoted to the position of CFO to replace Mr. Brown although some of Mr. Brown's former duties would be spread to other senior officers. Mr. Goegan says that he asked Mr. De Zen what his new compensation package would be. He says that Mr. De Zen told him that he would get a raise in salary and that in lieu of bonus, he was re-allocating Mr. Brown's 3% interest in the Premdor warrant to be shared by Mr. Goegan and two others, Lu Galasso and Mr. Brocklehurst.

[92] The defendant points out since the Premdor warrant remained under water, it had no value at that time. Its value depended on whether the price of shares of Premdor on the stock market ever rose above $13.25. The warrant could hardly be thought of as valuable and certainly not as a fair replacement for the substantial bonuses paid to Royal Group's senior officers under Royal Group's bonus plan. If it was valuable asset with a portion already being held in trust for Mr. Brown, how could it be taken from him?

[93] Mr. Goegan advised that he was sufficiently focused on his compensation so that before the ink was dry on his promotion, one of the first conversations he had with Mr. De Zen, in August, 2001, four months before Mr. Brown even retired, was to ask about the salary implications of the proposed promotion. Yet, despite his mercenary approach, he apparently accepted without question an asset with no value and only some unknown, potential, future value in lieu of what otherwise promised to be very significant bonus entitlement of his new senior position.

[94] The defendant denies that the Premdor warrant was ever held in trust by Royal Group or by Mr. De Zen at all. Therefore no one raised the issue of what kind of trust allows the trustee to name the beneficiaries, grant them an allotment of the trust property, and then change both the identities of beneficiaries and the quantum of their interests at will over time. The certainty of objects required for a valid trust would seem to be in question. Absent argument on the relationship between powers of appointment and trust certainty, I make no findings on this issue. It simply occurs to me that what is suggested by Mr. Goegan is a very unusual and complex structure that has no support in the evidence beyond the incredible testimony of Mr. Goegan and Mr. Dunsmuir.

[95] Mr. Goegan needs a basis to try to argue that he obtained an interest in the warrant as early as August, 2001 to fit with the tax filings that he made. The foregoing was his story although it makes little business or common sense.

[96] It fell to Lu Galasso to follow the market price of the Premdor warrant. On October 26, 2001, the market price of Premdor shares reached the strike price. Up to that time, had it been transferable, the warrant could have been traded with no gain being incurred. The price increased thereafter to the point that Mr. Galasso began discussing the exercise of the warrant.

[97] The warrant was exercised by Royal Group on February 26, 2002. On that day, Royal Group wrote to Premdor (then re-named to Masonite) and asked for the shares to be

delivered in return for payment of the strike price of $2.65 million (200,000 times $13.25) by Royal Group. Masonite issued the share certificate to Royal Group within a few days.

[98] In preparation for the share issuance, Mr. Goegan had accounts opened at a brokerage house to receive the 200,000 shares for Royal Group. Mr. Dunsmuir had corporate documents prepared for himself and Mr. De Zen to sign that purported to authorize Mr. De Zen to transfer the shares obtained under the Premdor warrant from Royal Group to the senior management group. The documents misrepresented to the broker that Mr. De Zen was complying with the by-laws of the corporation in authorizing the broker to transfer Royal Group's 200,000 Masonite shares to the individuals. Mr. Goegan already had accounts at that brokerage. He arranged for accounts to be opened for each of the other employees and he told each of them how much they had to pay to reimburse Royal Group for their respective shares of the exercise price that it had paid to Premdor. He oversaw the movements of funds generally.

[99] This all happened within a few days. Mr. Goegan sold his shares in two tranches on March 8 and 14, 2002. On March 18, 2002, the broker's trade confirmation slips showing the sales by Mr. Goegan were cancelled and replaced by confirmations showing the sales having been made by Mr. Goegan as trustee for his children.

[100] In all, the employees sold the Masonite shares for a total value of over $4 million. The total profit realized after deducting the strike price was approximately $2.03 million. Mr. Goegan's personal profit was almost $200,000. Mr. Dunsmuir's profit was almost $510,000. Mr. De Zen's profit was just under $710,000.

[101] The employees' receipt of their shares of the profit of the Premdor warrant was characterized as bonus in the books and records of Royal Group. The management bonus numbers were disclosed to the auditors.

[102] Although the auditors knew of the existence of the Premdor warrant and they knew the amounts of managements' bonuses for 2002, nothing in evidence suggests that anyone told the auditors that the bonuses had not been paid under the bonus plan but that the corporation had exercised its rights under the Premdor warrant and divvied up the resultant shares among senior management.

[103] The amounts received by senior management were included in the bonus numbers set out in the Management Proxy Circular for that fiscal year. What was not disclosed however, was that the bonus numbers were not regular bonus paid under the bonus plan in the ordinary course. Although there had been no approval by the shareholders of any change in the bonus plan as required under the plan, the senior officers buried in their regular bonus disclosure their appropriation of the corporate asset once it had become valuable.

[104] Mr. Goegan points out that he changed the wording of the Management Proxy Circular that year to disclose "very clearly" the Premdor warrant realization. Instead of the

circular saying that senior management received bonus of 2% of EBITDA under the bonus plan as it always had in past, Mr. Goegan revised the wording to say,

> The compensation consists of…a semi-annual bonus (which includes an EBITDA based bonus) and stock options."

[105] The parenthetical comment was Mr. Goegan's addition. Closely parsed, the wording suggests that since the bonus "includes" an EBITDA-based bonus, it must also be made up of something else. On the next page of the circular, the bonus plan is properly described in relation to EBITDA only. The something else that is hinted at in the parenthetical comment is never mentioned. If the wording added by Mr. Goegan was intended be transparent disclosure of the Premdor warrant it was rather opaque. It certainly was neither clear nor very clear. It was not disclosure of the Premdor warrant at all.

[106] Mr. Slaght and Mr. Sorbara were not provided with a blackline of the prior year's circular so as to have their attention brought to the parenthetical comment inserted by Mr. Goegan. Quite simply, they did not catch the subtlety of his change. Nor ought they to have been expected to do so. I take judicial notice that the word "includes" would not typically be expected to mean "This is disclosure that the senior officers of the corporation misappropriated a $4 million corporate asset". And that probably was the point of the change. Mr. Goegan used wording that he could later point to in order to suggest that he had made disclosure while confident in the knowledge that no reasonable person reading a dense corporate disclosure document would be likely to realize from his parenthetical comment that management had decided to take a $4 million asset and call it bonus without seeking shareholder or board of directors approval.

[107] The evidence concerning the back-dating scheme that ensued illuminates the actual process and the lack of credibility of Mr. Goegan's testimony.

[108] By email dated January 24, 2002, Mr. Galasso wrote to Mr. Goegan to propose what Mr. Galasso called a "concept" for the warrants. As the share price by then was climbing to the point that senior management realized that they might consider exercising the warrant, Mr. Galasso had turned his mind to taxation. He was concerned that the profit that had accrued since the market price exceeded the strike price under the warrant in late October, 2001, could be taxed as income from employment. He preferred to have the profit taxed as capital gains to reduce the amount of tax that he and his colleagues would have to pay on their respective shares of the profit. He was asking for Mr. Goegan's input into a chronology that supported capital gains treatment.

[109] Mr. Galasso's "concept" starts with the idea that the warrants were assigned by Royal Group to Mr. De Zen and management when it was first received in 2000. Mr. Galasso asked Mr. Goegan whether this ought to be phrased as a trust or a right issued by Royal Group to allow the senior management employees to acquire the shares once the warrant was exercised. It

is apparent in this question that the alleged trust or right did not yet exist but were options being floated by Mr. Galasso.

[110] Mr. Galasso's "concept" document then proposed that the exercise of the warrant be said to have been conditional on the completion of certain product development milestones being reached by the joint venture. This was simply not the case. There were no exercise conditions contained in the warrant. Mr. Galasso advised Mr. Goegan that this proposal was designed to reduce the implicit value of the warrant. He then proposed stating that the milestones were completed in October, 2001 so Mr. De Zen exercised the warrant and requested the shares at that time. Mr. Galasso made specific reference to the date of October 26, 2001 as the date when the strike price was reached. There would be no capital gain incurred by an exercise of the warrant right at the strike price. Mr. Galasso advised:

> The exercise should be documented with a form letter to Royal [with checks [*sic*] attached].

[111] Royal Group actually exercised the warrant in writing and delivered its cheque to pay for the issuance of the shares provided under the warrant on February 26, 2002. It was not exercised nor were the shares requested in October. This was just a fictional construct being developed by Mr. Galasso with Mr. Goegan's assistance to reduce taxes.

[112] Mr. Galasso sent a further iteration of his "concept" to Mr. Goegan on January 31, 2017. This version says that the warrant (actually he incorrectly refers to "warrants") were assigned on the day received to Mr. De Zen in trust for "the management team who worked on the Premdor deal." It then suggests that in August, 2001, subsequent to Gary Brown's retirement announcement, the warrants were "allotted to the management group. Presumably by Mr. De Zen." It continues that on October 26, 2001, Mr. De Zen exercised the warrants by sending a form letter to Royal Group requesting that the warrants be exercised and the shares requested at the strike price of $13.25.

[113] Mr. Galasso needed to explain why the shares were not issued until February if Mr. De Zen had exercised the warrant the prior October. He proposed the "concept" that while Royal Group acknowledged the exercise request, it indicated that "a time delay will most probably be experienced due to the recent merger of Premdor and Masonite and the name change." He continued, that "after several delays the Masonite shares were received." This was pure fiction. When Royal Group exercised the warrant on February 26, 2002, Premdor (then Masonite) delivered the requisite shares forthwith as required. There was no request for the exercise of the warrant in October; no indication that the merger of Premdor and Masonite might cause a delay; and no actual delay in the delivery of the shares.

[114] Mr. Goegan commented on this iteration of the tax "concept" that evening. Mr. Goegan changed the language proposing that Mr. De Zen had obtained the warrant in trust for the employees who had worked on the Premdor deal. Mr. Goegan had not worked on the deal and would not have qualified on that basis. He suggested instead the "concept" that Royal

Group's right to receive the warrants was assigned to "Vic De Zen in trust for the management team who finalized the commitment satisfaction on the Premdor deal." It is not at all clear what the "commitment satisfaction" refers to or how Mr. Goegan or the others whom Mr. De Zen allowed to share in the warrant might have been part of that team.

[115] Mr. Goegan accepted the "concept" of the October 26, 2001 exercise date and proposed in addition that on that day "certain members assigned their rights under the warrant to other parties at the strike price of $13.25." He was setting up a story to let him claim to have gifted his shares to his children at the strike price so he could claim that he engaged in income splitting transactions before incurring any gain in his own name.

[116] Mr. Goegan was cross-examined extensively on these and related documents. At its highest, he was left to claim that when Mr. De Zen told him in August, 2001 that he would share in Gary Brown's 3%, this amounted to a valid assignment of the unassignable warrant to him. He then claimed that he heard some talk in Royal Group about the exercise of the warrant in October. That became support for an argument that Royal Group had in fact exercised the warrant as claimed in the "concept" despite the letter exercising the warrant being dated and sent on February 26, 2002. Mr. Goegan said that he had a telephone call with Lu Galasso in October, 2001 during which Mr. Galasso first raised the tax issues. Mr. Galasso apparently told Mr. Goegan that the shares could be put into family trusts to achieve an income split. That conversation became Mr. Goegan's evidence that he had actually transferred his interest in the shares to his children in trust that day despite the broker's documentation showing that the shares were put into Mr. Goegan's name and sold in his name until that was changed later retroactively.

[117] In fact, management did purport to sign a number of documents to support the story set out in the "concept." In February, 2002, back-dated letters were prepared for Mr. De Zen purporting to document the transfer of the warrant in October, 2001 and claiming delay. In July, 2002, back-dated assignments of shares from management to their families were drafted showing dates in October, 2001 to support claims for income splitting rollovers.

[118] Upon the special committee of the board of directors discovering the details of the Premdor warrant transactions after Mr. Goegan's employment had already been terminated, Mr. Goegan and the other employees involved retained tax counsel to make voluntary disclosure to the CRA so as to have their capital gains blessed despite the back-dating of documents. I need not assess in detail Mr. Goegan's participation in the voluntary disclosure effort after he was already gone from Royal Group. While their counsel gave a transparent hint to the CRA that documents supporting the deal had been back-dated, the senior managers had their tax counsel tell the CRA the fictional events developed in the "concept" rather than making full, plain, or

truthful disclosure of the facts. Nothing in that process shines any positive light on Mr. Goegan or his credibility.[3]

[119] There is another element of the story that was covered in testimony that deals with a public outcry from institutional shareholders upon the disclosure of management's bonuses in fiscal 2002. The public shareholders knew nothing of the Premdor warrant situation. They reacted just to the magnitude of management bonuses at a time when corporate performance was waning. Mark Badger, the management employee responsible for shareholder relations, prepared draft backgrounders for the independent board members who had to answer to the public shareholders for the size of management's bonuses. Mr. Goegan was copied on these communications. The story prepared for the independent directors did not mention the Premdor warrant at all. Rather, management claimed that Mr. De Zen had declared increased bonuses that made up for EBITDA-based bonuses forgone the prior year. That was not the basis on which Mr. De Zen's or the others' bonuses had increased. The bonuses increased dollar-for-dollar with the allocation among the senior managers of the Premdor warrant proceeds due to the happenstance that the warrant came into the money during that fiscal year and its proceeds were secretly taken by senior management.

[120] This was just one of several opportunities that Mr. Goegan had to make disclosure of the fact that he had been granted a $200,000 share of the Premdor warrant by Mr. De Zen. Instead he allowed a different story to be told to the independent directors that covered up the misappropriation of the Premdor warrant by Mr. De Zen, Mr. Goegan, Mr. Dunsmuir, and the others. He later participated in the tax scheme that told yet a different untrue story to the CRA.

Mr. Goegan's Position

[121] Mr. Goegan argues that on November 26, 2004, Royal Group articulated three reasons for the termination of his employment:

(a) He facilitated the Vaughan West land flip by writing the cheques to participants;

(b) He failed to disclose the Vaughan West land flip to the board of directors or at least Mr. Slaght; and

(c) He hid the Vaughan West land flip until Kroll discovered it in its 2004 investigation for the special committee of the board of directors.

[3] I wish to make clear that there is no basis in the evidence to suggest that the tax lawyer retained by Messrs. Goegan and his colleagues had any knowledge that facts that he conveyed to the CRA were not correct.

[122] He says that each of these reasons is false factually. He did not sign the Vaughan West transaction cheques. He did prepare one or more cheque requisitions which was of no real consequence in the overall transaction. He says he disclosed to Mr. Slaght that Mr. De Zen was buying the Vaughan West land and that there was discussion of him selling it to Royal Group. Mr. Goegan also says that Kroll did not discover the Vaughan West flip in 2004. Rather, it was referenced by the OSC in the investigation that led to Kroll being retained. Mr. Goegan provided all of the relevant documents to Kroll and pointed them to all of the relevant financial entries that were readily discernable in the books and records of Royal Group.

[123] Mr. Goegan argues that had he been given a fair hearing by the special committee of the board of directors of Royal Group, they would have understood that their conclusions about him were wrong. He says that Kroll reported only interim, incomplete findings that did not amount to a full and fair investigation. Rather, the board, through its special committee of independent directors, was in need of scapegoats to respond to the pressure for action being applied by the OSC, the RCMP, and public shareholders. The special committee decided to make a dramatic gesture by firing the three most senior officers of the company. He was the person inhabiting the CFO role at the time and was unfairly made to suffer for the sins of Mr. De Zen and the prior CFO Mr. Brown.

[124] Mr. Goegan argues that the decision as to whether his conduct amounts to cause for summary dismissal is a contextual one. The decision must be made with reference to the entire context of the facts that existed at the time. He says that in the context of Royal Group from 1997 to 2004, he did nothing to sever his employment relationship with the company. It was Vic De Zen’s company. The board of directors was wholly complacent as was common at that time. Mr. De Zen had unparalleled and unchallenged authority. His acts were the authorized acts of the company with the board’s tacit, if not explicit, approval. At worst, even if Mr. Goegan’s acts were offside a formalistic assessment of the applicable law, they were well within his employment duties as they were directed by and supported by Mr. De Zen.

Royal Group's Position

[125] The defendant argues that as an officer of the corporation, Mr. Goegan owed fiduciary duties to Royal Group. He was a fiduciary due to his status. In addition, as a member of senior management and the face of the company in real estate matters, he exercised the type of power and authority to render the company vulnerable to unilateral exercises of his discretionary authority and as such, he was a fiduciary in the particular circumstances of this case.

[126] In any event, if he was not properly classified as a fiduciary at law, he owed and breached a duty of fidelity that applies to all employees. He also assisted the Executive Management in breaches of their undoubted fiduciary duties. The seminal decision of Chief Justice Estey (as he then was) on this last point in *Alberts et al. v. Mountjoy et al.*, [1977] O.J. No. 2334, (Ont HCJ) at para. 27, remains good law. All of these breaches of duty were severe and are the type that are recognized as amounting to cause for dismissal even in the context of a corporation whose leader engages in the same misconduct.

Analysis of Fiduciary Duties and Cause for Termination

[127] A fiduciary employee owes the employer duties of loyalty, honesty, candour, and scrupulous avoidance of actual and potential conflicts of interest. *Canadian Aero Service Ltd. v. O'Malley*, [1973] S.C.J. No. 97 at para. 24. Moreover, a fiduciary is prohibited from usurping corporate opportunities presented to the employer. *Canaero* at para. 25. This is generally a strict area of the law. As discussed by the Supreme Court of Canada in *Canaero*, there is some controversy in the case law as to whether a fiduciary can ever be entitled to take up an opportunity offered to the corporation. None of this is new.

[128] The issue is certainly contextual. But I know of no case where senior management has been held to be entitled to usurp for themselves an opportunity that the corporation had the ability to pursue and then flip the opportunity to the corporation for a substantial secret profit with no disclosure of the full facts to and approval of the board of directors. This case is not a close call. There was no pretense of compliance with s. 120 of the *CBCA* or s. 4.18 of the By-law No. 1 or with *Canaero*. Misappropriation of corporate assets is a breach of duty of a most serious nature. Serious breaches of statutory or fiduciary duties generally sever the employment relationship and meet the common law definition of cause for dismissal. *Unique Broadband Systems, Inc. (Re),* 2014 ONCA 538 (CanLII), at para. 125.

[129] A person who owes fiduciary duties to a corporation is not entitled to just do as he or she is told by the dominant shareholder. The duties are owed to the corporation and not the majority or any shareholder. The fiduciary's duty to the corporation includes the duty to tell the dominant shareholder that what he proposes is wrongful and to disclose misconduct committed even by the undoubted leader. It may well be that the corporate life of person who crosses the dominant shareholder will be "neither happy nor long" as Farley J. famously wrote. But doing what is right is the standard required of corporate fiduciaries in Ontario. *820099 Ontario Inc. v. Harold E. Ballard Ltd*. 1991 CarswellOnt 142 (ON SC).

[130] The court enforces fiduciary duties strictly to ensure that there is no incentive for fiduciaries to violate their high ethical and legal duties. McLachlin J. (as she then was) stated the principle this way in *Soulos v. Korkontzilas*, [1997] S.C.J. No.52, at para. 50,

> I agree with the Court of Appeal that a constructive trust is required in cases such as this to ensure that agents and others in positions of trust remain faithful to duty of loyalty: see *Hodgkinson v. Simms, supra, per* La Forest J. If real estate agents are permitted to retain properties which they acquire for themselves in breach of a duty of loyalty to their clients provided they pay market value, the trust and confidence which underpins the institution of real estate brokerage will be undermined. The message will be clear: real estate agents may breach their duties to their clients and the courts will do nothing about it, unless the client can show that the real estate agent made a profit. This will not do. ***Courts of equity have always been concerned to keep the person who acts on behalf of others to his ethical mark; this Court should continue in the same path.*** [Emphasis added.]

[131] I find that Mr. Goegan was a fiduciary *vis-à-vis* Royal Group at all material times. He was the CFO at the time that Royal Group exercised the Premdor warrant and he and other senior management took the proceeds. As the face of the company responsible for real estate acquisition reporting directly to Mr. De Zen, Mr. Goegan's position, even in 1997, was among the most senior and most sensitive in the company. He received confidential market contacts for Royal Group. The corporation was vulnerable to the discretion that he exercised such as where he chose to direct those contacts. He was not just a junior clerical worker as he sought to portray himself. He stood up to Mr. De Zen to make his pitch that Royal Group should be interested in the Vaughan West land. He was the type of top manager exercising the type of extraordinary and sensitive authority within the corporate enterprise upon whom the law imposes fiduciary duties. He was also a Chartered Accountant with professional fiduciary duties to his client throughout.

The Non-fiduciary Employee's Duty of Fidelity

[132] Even if Mr. Goegan was not a fiduciary at any relevant time, like all employees, he owed a duty of fidelity to Royal Group. Breaches of this duty also generally justify summary dismissal. Misappropriation of assets and taking a secret profit are the types of infidelity that sever the employment relationship for non-fiduciary and fiduciary employees alike. So too does participating in a dishonest scheme even under the direction of a superior. As Goudge JA wrote in *Spendlove v Thorne Ernst & Whinney*, 1999 CanLII 3814 (ON CA), at para. 22:

> Ms. Spendlove was an active and dishonest participant in this illegal scheme which she carried on in the context of her work for her employer. It does not avail her that she did not benefit personally, nor that her actions were not directed against her employer. Her conduct was fundamentally inconsistent with the nature of her employer's business. It violated the implied term of fidelity by which she was bound and constituted just cause for her dismissal.

[133] These words apply with equal force to Mr. Goegan in respect of both the Vaughan West land flip and the Premdor warrant. On the Vaughan West land flip he facilitated the usurpation of a corporate opportunity by senior managers. Then, at the expense of the company, he helped them make a secret profit by flipping to Royal Group the asset that was the subject of the corporation's opportunity. On Premdor he took corporate funds personally without proper corporate authority. He participated in hiding what he and the others had done. One need not look deeply into corporate law or employment law to understand the infidelity of these acts.

The Duty to Disclose

[134] A fiduciary who knows about wrongdoing committed against the beneficiary has a duty to tell the beneficiary. In *Canson Enterprises Ltd. v. Boughton & Co*., 1991 SCJ 91, the Supreme Court of Canada held that a lawyer breached his duty to his client who was the buyer of land. The land had been subject to a wrongful flip by an intermediate buyer in breach of its duties to the final buyer. The lawyer had acted on the intermediate flip. It is significant that in that case, the lawyer had not been a principal participating in the flip. Rather, he knew about it and as a fiduciary to the ultimate buyer, the lawyer had a duty to disclose to his client the breaches of duty committed against it. Similarly, the fact that Mr. Goegan did not make a personal profit on the Vaughan West land flip is no answer in law to the claim that his knowledge and silence were breaches of his fiduciary duty to disclose the Vaughan West land flip. His common law duties of loyalty, fidelity, and candour required him to disclose to the corporation the conflicts of interest and the misappropriation of corporate opportunities and assets of which he had knowledge from his participation in the transactions. See also *EM Plastic & Electric Product Ltd. v. Hobza*, [1992] OJ No. 4173 (Gen. Div), at paras. 235 and 236, *affirmed*, [1993] OJ No 5078 (CA), *leave to appeal refused*, [2007] SCCA No. 92.

Whether the Vaughan West Land was flipped at FMV is Irrelevant

[135] Moreover, Mr. Goegan's proposed justification, that the Vaughan West land was purchased by Royal Group at fair market value, is no defence at all. First, it is contrary to the facts as I have found them above. But even if I had found that the sale at $6.5 million above the purchase price 60 days earlier was at fair market value, the Court of Appeal has prohibited that argument. *Charles Baker Limited v. Baker*, [1954] OJ No. 543 (CA) at paras. 13 and 16. Even if the value of the land increased after it was first offered to Royal Group, that value ought to have already belonged to Royal Group. The senior managers of the corporation had no right to usurp the opportunity that was Royal's opportunity. The must account for any profit that they made regardless of whether Royal Group suffered actual loss. The actual value on the date of the flip is irrelevant under the corporate opportunity doctrine.

Condonation Requires Full Disclosure - The Contextual Analysis

[136] The defendant argues that the management of Royal Group, Mr. De Zen, Mr. Brown, and Mr. Dunsmuir condoned any wrongdoing that he is found to have committed. Mr.

De Zen was the undoubted autocratic leader of the company. He had full knowledge of the affairs at issue and plainly approved of Mr. Goegan's involvement.

[137] In *Paglioroli v Rite-Pak Produce Co.,* 2010 ONSC 3729 (CanLII) Grace J. applied the law as set out by the Court of Appeal in *McIntyre v Hockin* (1889), 16 OAR 498 (Ont CA) that an employer who retains an employee for a considerable period of time after discovering that the employee committed misconduct will be found to have condoned the wrongdoing and will be prohibited from dismissing the employee thereafter absent further, new misconduct. The Court of Appeal was clear however that a finding of condonation requires that the employer be fully informed about the wrongdoing alleged so that its decision to act or to refrain from acting can be said to have been an informed decision.

[138] In *Paglioroli,* Grace J. found that the court should conduct a hierarchical analysis of the inner-workings of the employer to discern the identities of the people with "the ability to terminate or trigger a review and influence the continuation of the employer-employee relationship." For the defence to apply, it is those people who have "to either have knowledge of the conduct in question or choose, for whatever reason, to ignore it or approve it."

[139] In *Paglioroli,* the employer was a private company. The employee was importing wine for the company illegally. Neither he, nor his superiors, were making profit at the expense of the company. Rather, management seized on the unlawful conduct of which they had been aware for a long time in order to justify taking steps that an arbitrator found had amounted to a constructive dismissal of the employee. There was no issue in that case as to whether management who participated in or benefited personally from the wrongdoing could be found to have condoned it on behalf of the employer.

[140] In the case at bar, all of the senior managers upon whom Mr. Goegan relies were themselves participants in the unlawful conduct. To his knowledge, they were imbued with conflicts of interest that prevents them from making or being seen to be authorized to make independent decisions on behalf of the corporation. He cannot have purported to rely on their approvals in good faith as he knew they were in conflict of interest and in breach of duty themselves. In fact, they all actively hid their misconduct from the independent directors who were, in the context and circumstances of this case, the only people who could have made an independent, informed decision on behalf of the corporation under s. 4.18 of By-law No. 1 and s. 120 of the *CBCA*. The law cannot allow a faithless fiduciary to approve his own misconduct.

[141] *Baranowski v. Binks Manufacturing Co.*, 2000 CanLII 22614 (ON SC) involved a publicly traded multinational corporation. The plaintiff was an employee of the organization for 29 years. His most recent posting was as President of the Canadian subsidiary. He was closely allied with Mr. Roche who was the President and Chairman of the Board of the US parent. Like Mr. De Zen, Mr. Roche was "the unquestioned ruler within the Binks pantheon." He had run the empire for decades. Maloney J. found that the company "was his fiefdom, and he ran it as he saw fit."

[142] Much like the current case, Maloney J. found that the company was under Mr. Roche's total and autocratic control to a degree that "was not compatible with the modern corporate organization." At para. 112 of the decision, Maloney J. found that the arguments of breach of fiduciary duty against the plaintiff and Mr. Roche could not succeed in that case given the board's complacency and its ongoing willingness to do whatever Mr. Roche directed. Maloney J. wrote:

> 112. While the defendant's have raised issues of breach of fiduciary duties in respect of the plaintiff and Roche failing to properly disclose or report their activities to their respective Boards, it was patently clear to me, after hearing the evidence, and with the benefit that only the trier of fact can have of seeing the witnesses as they present their evidence, that the Directors of Binks Canada were, for the most part, straw-men who admitted to being nothing more than a rubber-stamp brigade for whatever Roche decided to put before them; or who continued on in accepting willful ignorance if he decided not to put things before them.
>
> 113. For example, when Binks Canada entered into the Magna deal, which was the largest single transaction entered into by the Binks organization globally, the Board of Directors was not consulted, nor were the contracts the new President of Binks U.S., the Board of Directors of Binks Canada was not consulted, and had no input into the decision at all.
>
> 114. This being the case, I consider Binks' complaints that the plaintiff is at fault for failing to provide the Directors with proper notice, or to seek a vote or resolution ratifying the transaction or contract, to be a rather opportunistic cry of injury. Practically speaking, nothing would have turned out differently if the Directors had been informed, because, as the decades of custom and practice clearly showed, they would simply have acquiesced to whatever Roche put before them anyway.

[143] The plaintiff argues that this same reasoning applies in this case. Had Mr. De Zen or Mr. Goegan made full disclosure of either the Vaughan West land flip or the Premdor warrant to the board of directors, the board would have done as Mr. De Zen wished. It did nothing to scrutinize thirteen related party transactions between Mr. De Zen and Royal Group some of which were plainly known to them. In *Baranowski*, Mr. Roche authorized loan forgiveness in favour of the plaintiff in a scheme that involved tax avoidance. The forgiveness was not recorded in the financial statements although it was referred to in a footnote. The issue was whether the plaintiff had breached his duties by authorizing the issuance of misleading financial statements. The court found that the process was designed by the company's auditor. However, the issue was disclosed to the board of directors expressly. The footnote was read aloud to the board of directors at the meeting at which the board adopted and approved the financial statements. The board knew about the accounting scheme and did not take any issue with it.

[144] It seems to me that this is a crucial distinction between the facts of *Baranowski* and this case. While the plaintiff casts much aspersion on the lack of effort of the board to conduct

due diligence and to ferret out details that were not forthrightly offered to it by management, in *Baranowski* the wrongdoing was actually disclosed to the board. It sat idly by despite that disclosure.

[145] There is another problem with reliance upon the *Baranowski* case and claiming that the board's failure to scrutinize related party transactions more closely means that it would have approved of the Vaughan West land flip and the Premdor warrant matter if they had been disclosed. A board of directors is entitled to expect management to comply with their disclosure duties. Its role is not to play detective. The court cannot guess what the board might have done had management disclosed its wrongdoing.

[146] In *UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc*, 2002 CanLII 49507 (ON SC) at para. 118, Lax J wrote:

> It is no answer to the duty to disclose to say the directors could have discovered this for themselves. The duty to disclose is an absolute one, because, without full disclosure, any investigation into whether the beneficiary would have acted in the same manner is impossible.

[147] An even more pointed statement of the strictness of the duty of full disclosure of conflicts of interest by fiduciaries was made by Arnup JA for the Court of Appeal in *Advanced Realty Funding Corp. v. Bannink*, 1979 CanLII 1681 (ON CA) at paras. 17 and 18:

> So strict is the duty of disclosure that it has been said it is not enough to give notice to the principal that there is another commission, leaving the principal to inquire what it is and how much: *Fullwood v. Hurley*, [1928] 1 K.B. 498, per Scrutton, L.J., at pp. 503-4. There must be the "fullest disclosure" and an informed consent by the principal: *Anglo-African Merchants Ltd. et al. v. Bayley et al.*, [1970] 1 Q.B. 311 at p. 322.
>
> Applying these principles to the present case, I am of the view that the plaintiff has not satisfied the onus upon it of showing full and complete disclosure to the defendant of the fact that it was going to be paid a finder's fee and how much that fee was. The plaintiff is, therefore, disentitled from receiving any remuneration from acting in the transaction of finding the defendant an acceptable mortgage. ***On the authorities, the Court does not engage in speculation as to what the principal might have done if disclosure had been made, nor is it an essential part of the relevant principle that there must have been detriment to the principal as a result of the non-disclosure***. [Emphasis added.]

[148] I respectfully question therefore whether it was open to Maloney J. to make the finding in para. 114 of his decision above in light of the Court of Appeal's statement of the principle in *Advanced Realty*. As a matter of law, I cannot inquire into what the board of directors might have done had Mr. Goegan disclosed senior management's usurpation of the Vaughan West corporate opportunity, the secret profits made by management on the Vaughan West land flip, or the appropriation by senior management of the Premdor warrant.

[149] Moreover, even if it were correct in law and possible to try to assess what the board might have done as part of addressing contextual factors to determine whether cause for dismissal exists as Mr. Goegan submits, I do not believe that it would be correct factually to find that the board would likely have done nothing in this case. On disclosure of senior management's misappropriations of corporate opportunities and funds, the independent directors would have formed a majority of the voting members of the board. The inside directors included conflicted senior managers who would not have been entitled to take part in any voting under the terms of the By-law No. 1 and the *CBCA*. While Messrs. Sorbara, Slaght, and Sardo certainly accepted the basic notion that Mr. De Zen was intended to be in charge and to have his entrepreneurial way, as men of integrity they would not have been inclined to, nor able to look the other way upon being advised of such serious misconduct. Unlike the inside directors whose fortunes rose or fell with Mr. De Zen's moods, the outside directors had day jobs. They had no incentive to risk their good names, their professional and community standing, or their integrity to assist management engage in personal enrichment at the expense of the corporation. In any event, the Court of Appeal provides that this is not a proper inquiry and I say no more about it.

[150] Counsel for Mr. Goegan asks why senior management would have risked the goose that laid the golden eggs represented by their very substantial shareholdings in Royal Group just for a few paltry millions of dollars. In light of the fact that they did just that, I suppose the question is best asked to them. Perhaps it depends on whether one can ever classify even a few million dollars of cash in hand as paltry.

[151] A case with similar facts to this one was decided by Metzger J. in *Kirby v Amalgamated Income Limited Partnership*, 2009 BCSC 1044. The employer in that case was a limited partnership whose units were publicly traded. Mr. Kirby was the charismatic and autocratic leader who was ultimately fired after the OSC raised questions about some of the transactions in which he had engaged. The partnership fired Mr. Kirby for cause for non-disclosure, breach of fiduciary duty, and other, similar allegations. At para. 170 Metzger J. discussed the contextual issue arising from the board of director's failure to supervise Mr. Kirby:

> [170]…The evidence establishes that the board remained indifferent to a number of issues, including the exact terms of Mr. Kirby's remuneration.
>
> [171] Although an employer's failure to supervise an employee is not a defence for Mr. Kirby's deficiencies, this is an important contextual factor. I am satisfied that the board bears some responsibility for consistently accepting and, at times, commending annual reports and other documents authored by Mr. Kirby.
>
> [172] A third contextual factor speaks to why there was so little oversight of Mr. Kirby and Amalgamated. The directors acted more like a group of investors watching over their investments than a professional board governing a business operation. Mr. Kirby's primary role, even as an employee of the company, was to increase each director's individual wealth. The board granted him a high degree of autonomy to carry out this goal. Thus, many of Mr. Kirby's "unilateral" actions in the administration of the company's affairs

> must be tempered by the directors' expectation that Mr Kirby would run Amalgamated single-handedly and inexpensively to maximize their personal profit.

[152] However, as highlighted in *Canaero*, each case is ultimately decided on its own facts and in its own context. Metzger J. provided his key findings of fact on the breaches of fiduciary duty proven against Mr. Kirby starting at para. 207 as follows:

> [207] A central contextual factor in assessing this alleged misconduct is the business culture and purpose of Amalgamated. In this circumstance, the directors acted more like investors than members of a professional board. From the perspective of the board, the purpose of Amalgamated was to increase each director's individual wealth, including that of Mr. Kirby. I am satisfied that this specific activity was condoned by the board.
>
> [208] On this basis, I am satisfied that Mr. Kirby was behaving reasonably in the circumstances.
>
> [209] Even if there were no approval or condonation, I am satisfied that Mr. Kirby's actions should, at most, be characterized as an error in judgment. He did not breach clear rules of fidelity: *Sheehan*, at para. 164. Nor was there intentional "deceitful and deceptive conduct": *Christensen v. McDougall,* 2001 CanLII 28309 (ON SC), [2001] O.T.C. 697, at para. 69, 14 C.C.E.L. (3d) 44 (Ont. S.C.J.).
>
> [210] In summary:
>
> > 1. Mr. Kirby personally profited;
> >
> > 2. Mr. Kirby listed Ms. Parker's trades but not his own;
> >
> > 3. Mr. Kirby had many opportunities to inform the board of his over-the-counter trades;
> >
> > 4. Mr. Kirby was the company's most senior employee and the board relied on him completely to conduct his and the company's affairs in an appropriate manner;
> >
> > 5. The company profited from Mr. Kirby's over-the-counter trades;
> >
> > 6. The board never stopped or commented on Ms. Parker's over-the-counter trades;
> >
> > 7. Article 66 of the general partner's Articles of Incorporation (479660) authorized directors to acquire target LPs; and
> >
> > 8. The board's oversight of the company's affairs was cavalier at best.

> Weighing these factors together, I am satisfied that there was no breakdown of the employment relationship on this particular ground of breach of fiduciary duty. I believe that had this been the sole misconduct at issue, the board would not have terminated Mr. Kirby's employment.

[153] Mr. Kirby engaged in trades that profited both the company and himself. That seemed to fit well with the board's view of his role. The corporation did not suffer deprivation for each dollar taken by senior management as did Royal Group. There was no breach of Mr. Kirby's duty of fidelity. There was no deceit or deception. While the inside directors at Royal Group might have shared the goal of profiting with Mr. De Zen on his private transactions, the same cannot be said for the public shareholders or the outside directors.

[154] If the plaintiff believed that the board of directors would have approved of the Vaughan West land flip and the Premdor warrant, then what would have been the harm of making disclosure to the board? At the very least, it seems to me, that rather than being heard to argue that the board would probably have approved, Mr. Goegan was obliged to give the board a chance to decide for itself. Under *Advanced Realty* Mr. Goegan cannot be heard to even make the argument when his silence, in face of a positive and strict duty to disclose, disabled the board of directors from exercising its oversight role.

[155] It is apparent from all of the foregoing cases, that even with the strictness of the duties involved and the importance of the policy reasons to enforce corporate fiduciary responsibilities and ethical behaviour, there can be contexts in which it is unfair to hold an employee liable for dismissal for cause for some breaches of duty especially where the corporate culture is particularly lax. I do not see how Mr. Goegan can fit into that narrow band however.

[156] First, he is a Chartered Accountant, a Vice President, and the CFO of a public corporation. His positions are fundamentally fiduciary in character and require a professional who answers to the highest of callings. Second, in this case, corporate assets were misappropriated at the expense of the corporation. The actions were not complimentary or profit-making for the corporation. They were acts of infidelity taken at the expense of the corporation. Third, Mr. Goegan failed make full and fair disclosure of either the Vaughan West land flip or the Premdor warrant to the independent directors who, far from being rubber stamps, were known to be people of integrity. The board of directors likely should have seen that there were related party transactions being conducted that were not being brought to it for approval. But that is a far cry from saying that the independent directors, whom Mr. Goegan understood to be guardians of the public investors' $185 million investment, created a culture in which Mr. Goegan ought to be relieved of the fundamental duties of his high office. The corporate culture was not lax because the independent directors allowed management to breach their duties. To the contrary, management's deception and failure to disclose their breaches of their duties was consistent with them understanding that what they were doing was indeed wrongful.

[157] I cannot find anything in the evidence concerning the context of the corporate culture at Royal Group, independent of senior management's own wrongdoing, to lead to a

finding that holding Mr. Goegan to his well-established and well-known legal, professional, ethical, and fiduciary duties is at all inappropriate or unfair in the circumstances. To the contrary, given the structural importance of the fiduciary duties of directors, officers, and senior managers to the proper functioning of business corporations and especially public corporations, holding Mr. Goegan to his legal, professional, ethical, and fiduciary duties is vitally important to the sanctity and security of Canadian capital markets. The message implicit in a decision to the contrary would be as startling as it would be harmful to the market place.

[158] Mr. Goegan had a choice. He could remain silent, curry favour, and perhaps one day be offered a share of the booty as indeed came to pass; or he could have blown the whistle. He chose the money. Wrong choice.

[159] Perhaps James L.J. overstated the point in *Parker v.McKenna* (1874-75) LR 10 Ch App 96 in finding that "the safety of mankind" turns on the strict enforcement of rules preventing fiduciaries from profiting at the expense of their beneficiaries. But it is an indication of a view, to which I subscribe, that it would be a most unusual case in which the rule should be otherwise. A case involving senior management taking secret profits and committing deception to cover their tracks is not likely to be one of them.

After-acquired Cause

[160] Finally, the court must scrutinize allegations of after-acquired cause with care and even some skepticism. The acceptance of after-acquired cause involves the risk that management has scoured the books and records to try to find justification for an over-zealous termination. The Premdor warrant issue was not discovered and advanced until years after Royal Group fired Mr. Goegan. However, it has long since been accepted that if the employee left evidence of cause for dismissal to be found, the fact that it was successfully hidden until its discovery cannot avail the employee. In any event, this issue too is not a close call. Mr. Goegan took almost $200,000 of the corporation's money. He actively hid the real transaction and participated in untruthful disclosures to the independent members of the board of directors and then to the CRA. One might consider whether the manner by which employees dealt with their personal taxes was any of the employer's business. But here Mr. Goegan was the most senior officer of the company with responsibility for its financial integrity including the lawful calculation and payment of its taxes. He was in a position requiring the utmost trustworthiness. A display of a lack of financial and personal integrity by Mr. Goegan in his dealings with the CRA concerning transactions conducted by the company is keenly relevant to his fitness to serve as CFO. The discovery that Mr. Goegan not only took money from the corporation but that he then participated actively in a scheme to create and back-date corporate documents to create a fictional cover story in order to reduce his personal taxes was cause to immediately disqualify him from holding any position of financial responsibility within Royal Group.

The Board's Investigation

[161] I do not accept Mr. Goegan's argument that there was unfairness in the investigation undertaken by the board of directors through its special committee and its consultant Kroll that impacted the company's right to dismiss Mr. Goegan for cause. Mr. Goegan was interviewed three times. Kroll and the board of directors knew that he explained his conduct in the Vaughan West land flip by relying on the advice of his superior Mr. Brown to the effect that the auditors determined that the transaction was immaterial and did not require disclosure. I agree with Messrs. Slaght and Sorbara that the board of directors, then represented by the special committee of outside directors, had sufficient evidence to reach the conclusion that the justification was lacking regardless of whether Mr. Brown supported it.

[162] Mr. Goegan was treated fairly. He was interviewed about the Vaughan West land flip and he was given opportunities to respond to the questions asked. He was invited to respond to questions concerning the Premdor warrant once those transactions were discovered and he declined. That was his right. There was no duty owed to Mr. Goegan requiring Kroll to complete a final report before the board of directors acted on the facts that it had on November 26, 2004.

[163] Nor was the manner of dismissal remarkable. The special committee waited for the end of the day on a Friday when most employees had left for the weekend. Mr. Goegan was told that he was fired and he was escorted from the building in a curt but professional manner. I have no doubt that it was both unpleasant and upsetting for Mr. Goegan. But he established no egregious, gratuitous, callous, or wrongful acts.

[164] Royal Group was required by securities law to publish a press release announcing the terminations of Mr. Goegan and the others who were fired with him. The press release was professionally written and truthful. Mr. Goegan objects to the statement in the press release that Kroll discovered the Vaughan West land flip when it was mentioned in the OSC investigation and Mr. Goegan himself had taken Kroll to the deal documents. Kroll did not discover that the transaction had occurred but that it was a flip in which senior management took a secret profit of $6.5 million at the expense of the company. I do not see the reference to Kroll's discovery in the press release as significant therefore.

[165] It follows that even if he had succeeded generally, the plaintiff made out no case for punitive or aggravated damages. Mr. Goegan was not set up as a scapegoat. I do not accept that the termination of Mr. Goegan's employment was conceived or carried out in bad faith or that it involved the commission of any independent actionable wrong by the employer. Neither was the manner of termination especially noteworthy or deserving of condemnation.

[166] The action is therefore dismissed.

Damages

[167] As noted at the outset, I will assess the damages to which Mr. Goegan would have been entitled had he succeeded in his claim for completeness only.

[168] Royal Group employed Mr. Goegan for 14 years. Mr. Goegan was 43 years old when his employment was terminated. He held a very senior position with a very substantial compensation package. He was in the prime of an upward career trajectory. While jobs at his level would not be plentiful, it seems to me that, but for the allegations of cause, Mr. Goegan would have been a very employable and attractive candidate. I accept that the very public allegations of cause prejudiced his prospects.

[169] In my view, Mr Goegan's age and tenure are not at the high end of the *Bardal* scale. His salary and seniority are. Taking all of the relevant factors into account, the reasonable notice period would have been in the range of 18 to 21 months. I would set the notice period at the top of the range, 21 months, to recognize that the goal of the notice period is to estimate a reasonable time for Mr. Goegan to find alternate employment and allegations of cause might well have made that a more difficult task for him.

[170] I would have fixed Mr. Goegan's annual base salary at $550,000, assorted perqs at $15,000, car allowance at $12,000, and benefits at $13,200 as claimed. As to bonus, I find that in the circumstances of this corporation, bonus was a particularly important part of compensation. Lower base salaries and substantial bonus compensation reflected the entrepreneurial spirit that was at the heart of the business model. As such, while discretionary in law, in fact bonus was paid regularly and predictably. Had he remained employed for 21 months absent allegations of cause, I am satisfied that Mr. Goegan would have received his 60% base bonus throughout the period.

[171] Mr. Goegan has not proven his claim for "super bonus" that was paid to the new management whose circumstances cannot be analogized to those of pre-existing management. Similarly, Mr. Goegan did not prove the terms for qualifying for retention payments or that he would have qualified for those payments had he remained employed under a notice of termination for 21 months. Finally, on the evidence led at trial, I am unable to find that Mr. Goegan would have obtained value from any RSUs or stock options that he might have had or received. Mr. Goegan did not claim damages related to stock options in his amended statement of claim. On discovery he said that he was not seeking recovery for options. There is no evidence that any options or RSUs held by Mr. Goegan would have vested during the reasonable notice period. While the company cashed out some others' RSUs and options sometime in late 2006, I was not provided any real indication of the applicable terms of these forms of securities or how and when the vesting came about. The burden was on Mr. Goegan to prove his entitlement to all of the heads of damages that he claimed. He proved only those referred to in the preceding paragraph.

[172] The total annual loss on the items approved above was $920,000. For 21 months, the amount is $1.61 million. Prejudgment interest was not discussed during the trial. Had I awarded damages I would have called for submissions on the rate and duration of prejudgment interest.

Costs

[173] The defendant may deliver no more than five pages of costs submissions by August 4, 2017. The plaintiff may deliver no more than five pages of costs submissions by August 18, 2017. Both parties shall deliver costs outlines regardless of the positions each adopts. The parties may also deliver copies of any offers to settle on which they rely. Submissions shall be delivered in searchable PDF format as attachments to an email to my assistant. No case law or statutory materials are to be delivered. References to case law or statutory material, if any, shall be made by hyperlink to CanLII or another publicly available reference source embedded in the submissions.

F.L. Myers J.

Released: July 20, 2017

CITATION: Dunsmuir v. Royal Group, Inc., 2017 ONSC 4391
COURT FILE NO.: CV-17-11687-00CL

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

DOULGAS DUNSMUIR and RONALD J. GOEGAN

Plaintiffs

– and –

ROYAL GROUP, INC.

Defendant

REASONS FOR JUDGMENT

F.L. Myers J.

Released: July 20, 2017

COURT OF APPEAL FOR ONTARIO

CITATION: Dunsmuir v. Royal Group, Inc., 2018 ONCA 773
DATE: 20180924
DOCKET: C64192

Rouleau, Pardu and Benotto JJ.A.

BETWEEN

Douglas N. Dunsmuir and Ronald J. Goegan

Plaintiffs (Appellant)

and

Royal Group, Inc.

Defendant (Respondent)

Milton A. Davis, Ronald D. Davis and Samantha Green, for the appellant

Nigel Campbell and Doug McLeod, for the respondent

Heard: September 11, 2018

On appeal from the judgment of Justice Frederick L. Myers of the Superior Court of Justice, dated July 20, 2017, with reasons reported at 2017 ONSC 4391.

REASONS FOR DECISION

[1] The appellant, Ronald J. Goegan, appeals the dismissal of his action for wrongful dismissal. The trial judge found just cause for his termination without notice.

[2] The respondent, the Royal Group, Inc., is a public company. The appellant was, by the time of his termination in 2004, Senior Vice-President and Chief

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Financial Officer and a member of the board of directors. The trial judge concluded that three incidents of misconduct justified his termination.

[3] The first incident involved a land flip whereby the controlling shareholder of the respondent, together with senior officers of the respondent (the controlling shareholder's group), bought property through a third party then immediately after closing, sold it to the respondent for $6.5 million more than they had paid, thereby profiting personally. Leading up to this transaction, the appellant, who at the time was the senior officer of the respondent responsible for real estate acquisitions, had been approached by the vendor's agent to enquire whether the respondent was interested in purchasing the property. After consulting with the controlling shareholder of the respondent, he indicated that the corporation was not interested in the property.

[4] Shortly thereafter, the appellant was asked by the controlling shareholder to assist him in effecting the acquisition of the property. Thereafter, the appellant was involved with and assisted in the acquisition by the controlling shareholder's group and the immediate resale to the respondent of the same property at a $6.5 million markup.

[5] Although the appellant knew that the respondent had been offered the opportunity to acquire the property and that within months of this the controlling shareholder's group had acquired and then sold the property to the respondent at the significantly higher price, the appellant did not disclose this information to

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anyone with oversight authority. As noted by the trial judge, he was “the senior-most person at Royal Group with significant involvement in the transaction who was not profiting personally in it.”

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[6] The second incident arose from the sale of a subsidiary of the respondent to another public company called Premdor. The purchase price included a share warrant that entitled the respondent to purchase an additional 200,000 shares of Premdor at a strike price of $13.25. After the share price rose, the warrants were redeemed for the benefit of the respondent’s senior management – including the appellant – for a total profit of approximately $ 2 million.

[7] When management’s bonuses, which included the profits made by senior management on the exercise of the warrants, were disclosed as part of the respondent’s regular reporting, there was a public outcry from shareholders. The appellant then allowed a different story to be told to the independent directors that covered up the reason for which senior management’s bonuses were greater than what the approved bonus plan provided.

[8] This led to the third incident: a tax scheme whereby the Canada Revenue Agency was misled about the exercise of the warrants in order to reduce senior management’s tax liability.

[9] The trial judge’s finding that the appellant had failed in his fiduciary duty to the respondent is anchored to these three incidents. The first two constituted failures to disclose related party transactions to the independent directors or the auditors. The

third incident also constituted a breach of fiduciary duty, in that it involved the falsifying of corporate documents for personal gain and in order to mislead the Canada Revenue Agency.

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[10] The appellant submits that the trial judge erred in law by:

1. Failing to follow the test in *McKinley v. BC Tel*, 2001 SCC 38, [2001] 2 S.C.R. 161. He submits that this test requires the trial judge to conduct a contextual analysis of the entire employment situation, which in this case involved a corporate culture dominated by an autocratic controlling shareholder;
2. Relying on *Advanced Realty Funding Corp. v. Bannink*, (1979), 27 O.R. (2d) 193 (C.A.), to conclude that what the board of directors would have done had he disclosed the events in question was irrelevant. He submits that *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 overruled *Advanced Realty* in the result that it was incumbent on the respondent to show that the board would have taken action;
3. Failing to properly consider that his actions had been condoned.

[11] We do not accept these submissions.

[12] *McKinley* does not assist the appellant. The trial judge was clearly alive to the corporate culture and made factual findings that were open to him on the evidence. In any event, no corporate culture existing in a public company can reasonably support the course of conduct of this fiduciary as evidenced by these three incidents of misconduct. They struck at the heart of the employment relationship.

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[13] Nor do we agree that *Hodgkinson* overruled *Advanced Realty*. *Hodgkinson* involved an assessment of damages, not a fiduciary's duty to disclose. With respect to condonation, the trial judge concluded, and we agree, that the appellant cannot rely on other senior managers who were themselves participants of the unlawful conduct to establish condonation.

[14] The appellant owed a fiduciary duty to the company and its shareholders which included a duty to disclose. The trial judge correctly set this out at para. 134 of his reasons:

> A fiduciary who knows about wrongdoing committed against the beneficiary has a duty to tell the beneficiary. In *Canson Enterprises Ltd. v. Boughton & Co*., the Supreme Court of Canada held that a lawyer breached his duty to his client who was the buyer of land. The land had been subject to a wrongful flip by an intermediate buyer in breach of its duties to the final buyer. The lawyer had acted on the intermediate flip. It is significant that in that case, the lawyer had not been a principal participating in the flip. Rather, he knew about it and as a fiduciary to the ultimate buyer, the lawyer had a duty to disclose to his client the breaches of duty committed against it. Similarly, the fact that Mr. Goegan did not make a personal profit on the Vaughan West land flip is no answer in law to the claim that his knowledge and silence were breaches of his fiduciary duty to disclose the Vaughan West land flip. His common law duties of loyalty, fidelity, and candour required him to disclose to the corporation the conflicts of interest and the misappropriation of corporate opportunities and assets of which he had knowledge from his participation in the transactions. [Citations omitted.]

[15] In summary, the trial judge did not err in law and his findings of fact were grounded in the evidence.

[16] The appellant has also raised an abuse of process allegation by submitting that the respondent relitigated facts found by the trial judge in the appellant’s lengthy criminal trial, resulting in inconsistent findings in the two proceedings. We do not accept this submission. The allegations were raised in the appellant’s pleading and struck out by the court in a 2013 order which was not appealed. The issue was therefore not before the trial judge. It cannot be raised now.

[17] The appeal is dismissed with costs in the agreed upon amount of $65,000 inclusive of disbursements and HST.

“Paul Rouleau J.A.”
“G. Pardu J.A.”
“M.L. Benotto J.A. ”

2018 ONCA 773 (CanLII)

TAB 3

COURT FILE NO.: 02-CV-238804CM1
DATE: 20051101

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:	
EXIDE CANADA INC.	L. Caylor, for the Plaintiff
Plaintiff	
- and -	
LORNE HILTS, MARGARET PRIJATELJ, MONTEZ RASOOL and RYAD LOGISTICS INC.	Margaret Prijatelj, in person
Defendants	
AND BETWEEN	
RYAD LOGISTICS INC.	
Plaintiff by Counterclaim	
- and –	
EXIDE CANADA INC. and EXIDE TECHNOLOGIES	
Defendant by Counterclaim	
	HEARD: October 12, 2005

SACHS J.

2005 CanLII 40363 (ON SC)

2005 CanLII 40363 (ON SC)

INTRODUCTION

[1] This is a motion to set aside a contract under Section 132 of the *Ontario Business Corporations Act*, R.S.O. 1990, c.B-16 ("OBCA"). The Moving Party, Exide, alleges that Mr. Hilts and Ms. Prijatelj, while officers and directors of Exide, caused Exide to enter into a contract with Ryad (a company that was essentially owned by Ms. Prijatelj) without disclosing to Exide that they had misappropriated $1,355,000.00 of Exide's funds and directed $300,000.00 of those funds to Ryad.

[2] Mr. Hilts did not appear on the motion. Counsel for Exide indicated that Mr. Hilts had counsel and that that counsel had advised him that Mr. Hilts was taking no position on the motion. Ms. Prijatelj appeared on her own behalf and on behalf of Ryad (having previously been granted leave to do so). I was also advised by counsel for Exide that Mr. Rasool was taking no position on the motion.

[3] At the outset of argument I raised, and counsel for Exide agreed, that in order to obtain the relief requested by way of a motion, he would have to satisfy me that there was no genuine issue that required a trial.

THE LEGISLATION

[4] Section 132 of the OBCA provides as follows:

> **Disclosure: conflict of interest**
>
> **132**. (1) A director or officer of a corporation who,
>
> > (a) is a party to a material contract or transaction or proposed material contract or transaction with the corporation; or
> >
> > (b) is a director or an officer of, or has a material interest in, any person who is a party to a material contract or transaction or proposed material contract or transaction with the corporation,
>
> shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his or her interest.
>
> **by director**
>
> (2) The disclosure required by subsection (1) shall be made, in the case of a director,
>
> > (a) at the meeting at which a proposed contract or transaction is first considered;

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(b) if the director was not then interested in a proposed contract or transaction, at the first meeting after he or she becomes so interested;

(c) if the director becomes interested after a contract is made or a transaction is entered into, at the first meeting after he or she becomes so interested; or

(d) if a person who is interested in a contract or transaction later becomes a director, at the first meeting after he or she becomes a director.

by officer

(3) The disclosure required by subsection (1) shall be made, in the case of an officer who is not a director,

(a) forthwith after the officer becomes aware that the contract or transaction or proposed contract or transaction is to be considered or has been considered at a meeting of directors;

(b) if the officer becomes interested after a contract is made or a transaction is entered into, forthwith after he or she becomes so interested; or

(c) if a person who is interested in a contract or transaction later becomes an officer, forthwith after he or she becomes an officer.

Where contract or transaction does not require approval

(4) Despite subsections (2) and (3), where subsection (1) applies to a director or officer in respect of a material contract or transaction or proposed material contract or transaction that, in the ordinary course of the corporation’s business, would not require approval by the directors or shareholders, the director or officer shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his or her interest forthwith after the director or officer becomes aware of the contract or transaction or proposed contract or transaction.

Director not to vote

(5) A director referred to in subsection (1) shall not vote on any resolution to approve the contract or transaction unless the contract or transaction is,

(a) an arrangement by way of security for money lent to or obligations undertaken by the director for the benefit of the corporation or an affiliate;

(b) one relating primarily to his or her remuneration as a director, officer, employee or agent of the corporation or an affiliate;

(c) one for indemnity or insurance under section 136; or

(d) one with an affiliate.

General notice of interest

(6) For the purposes of this section, a general notice to the directors by a director or officer disclosing that he or she is a director or officer of or has a material interest in a person and is to be regarded as interested in any contract made or any transaction entered into with that person, is a sufficient disclosure of interest in relation to any contract so made or transaction so entered into.

Effect of disclosure

(7) Where a material contract is made or a material transaction is entered into between a corporation and a director or officer of the corporation, or between a corporation and another person of which a director or officer of the corporation is a director or officer or in which he or she has a material interest,

(a) the director or officer is not accountable to the corporation or its shareholders for any profit or gain realized from the contract or transaction; and

(b) the contract or transaction is neither void nor voidable,

by reason only of that relationship or by reason only that the director is present at or is counted to determine the presence of a quorum at the meeting of directors that authorized the contract or transaction, if the director or officer disclosed his or her interest in accordance with subsection (2), (3), (4) or (6), as the case may be, and the contract or transaction was reasonable and fair to the corporation at the time it was so approved.

Confirmation by shareholders

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> (8) Despite anything in this section, a director or officer, acting honestly and in good faith, is not accountable to the corporation or to its shareholders for any profit or gain realized from any such contract or transaction by reason only of his or her holding the office of director or officer, and the contract or transaction, if it was reasonable and fair to the corporation at the time it was approved, is not by reason only of the director's or officer's interest therein void or voidable, where,
>
> (a) the contract or transaction is confirmed or approved by special resolution at a meeting of the shareholders duly called for that purpose; and
>
> (b) the nature and extent of the director's or officer's interest in the contract or transaction are disclosed in reasonable detail in the notice calling the meeting or in the information circular required by section.
>
> **Court setting aside contract**
>
> (9) Subject to subsections (7) and (8), where a director or officer of a corporation fails to disclose his or her interest in a material contract or transaction in accordance with this section or otherwise fails to comply with this section, the corporation or a shareholder of the corporation, or, in the case of an offering corporation, the Commission may apply to the court for an order setting aside the contract or transaction and directing that the director or officer account to the corporation for any profit or gain realized and upon such application the court may so order or make such other order as it thinks fit.

Were Mr. Hilts and/or Ms. Prijatelj Officers or Directors of Exide at the Time the Contract Was Entered Into?

[5] The contract in question was negotiated in the spring of 2002. It was signed in June of 2002, but dated May 24, 2002.

[6] There is no dispute that throughout this time Mr. Hilts was an officer and director of Exide. He was appointed as such on March 17, 1999 and was Exide's President throughout the period from May, 2002 until he was terminated in November of 2002.

[7] Exide alleged in its material that Ms. Prijatelj was also appointed an officer in March of 1999. Ms. Prijatelj, in her material, stated that she was not sure of her status with Exide. She believed that she had been made an officer of Exide, but a recent corporate search revealed that she was not listed as such on the company's records. Thus, she submitted that she may have only been a signing officer with the Bank and not a corporate officer. Ms. Prijatelj was Mr. Hilts' executive secretary. She also had cheque-signing authority. Ms. Prijatelj left her employment

with Exide on May 24, 2002. On the basis of the material before me, I could not conclude that Ms. Prijatelj was an officer of Exide at the time the contract was entered into. In particular, the corporate searches that were attached to the defendant's record did not show her as such and the plaintiff filed no records that did.

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Did Mr. Hilts or Ms. Prijatelj Have a Material Interest in the Contract That Was Not Disclosed to Exide?

[8] The contract in question was with Ryad Logistics Inc.. Ms. Prijatelj directly or indirectly owns 85% of Ryad.

[9] Ms. Prijatelj denied that Mr. Hilts had any interest, direct or indirect in Ryad. However, what is clear from the record is that on November 1, 2001 Mr. Hilts and Ms. Prijatelj signed a cheque from Exide payable to a joint account that they held together personally for $1.355 million dollars. The cheque was requisitioned by Mr. Hilts and signed by both of them. On June 4, 2002, $300,000.00 of this money was transferred from Mr. Hilts' and Ms. Prijatelj's joint account to Ryad's account. This was before the contract between Ryad and Exide was actually signed. According to Ms. Prijatelj's own material that contract was not signed until June 11, 2002.

[10] According to Exide's material, they were not aware of this fact when the contract between Exide and Ryad was being negotiated. No where in the defendant's material is there any suggestion that Exide was advised that Ms. Prijatelj and Mr. Hilts had taken $300,000.00 of Exide's money and deposited it into Ryad's account. Exide only discovered this transaction and the other payments to Ms. Prijatelj and Mr. Hilts when they commenced an investigation into Ms. Prijatelj's and Mr. Hilts's activities after receiving an anonymous letter in November of 2002. That letter was addressed to the C.E.O. of Exide's U.S. Parent Corporation.

[11] It is clear that Ms. Prijatelj had a material interest in Ryad. It is, in my view, also clear that Mr. Hilts had a material interest in Ryad by virtue of the fact that he helped direct $300,000.00 of Exide's money towards Ryad during the time that Exide was negotiating its contract with Ryad. He also had a close personal relationship with Ms. Prijatelj that was evident from his willingness to participate in a scheme to take Exide's money and direct it to a corporation that she was the majority shareholder of. A material interest includes a personal relationship with the person who was a party to a material contract. Even where a director has no monetary interest in a person, but the negotiation involves a close personal friend of one of the directors the transaction ought to be suspect.[1] Furthermore, if Exide had known that they were entering into a contract with a corporation that was controlled by someone who had taken their money without their knowledge, it is self-evident they would never have chosen to deal with that corporation.

WAS THE CONTRACT A MATERIAL CONTRACT?

[1] B.L. Welling, *Corporate Law in Canada: the Governing Principles,* 2nd ed. (Vancouver: Butterworths, 1991) cited with approval in *McAteer v. Devoncroft Developments Ltd.*, [2002] 5 W.W.R. 388 ("*McAteer*") at 474 (Alta. Q.B.).

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[12] There is no issue that the contract was a material contract – both financially and in the broader sense encompassed by the legislation. The contract was for an integral and key component of Exide's business. According to the defendant's material, from May to September 30, 2002, Ryad charged Exide $1,826,365.26.

SHOULD THE CONTRACT BE SET ASIDE?

[13] Given the nature of the non-disclosure, it is my view that the contract should be set aside, regardless of whether Exide received value for its money from Ryad. It is clear that Mr. Hilts was a director and officer of Exide when he breached his fiduciary duty to Exide by causing them to enter into the contract with Ryad, without disclosing the true extent of his connection to Ryad and Ms. Prijatelj. Therefore, I am prepared to make an order that he account to Exide for any profit or gain he realized as a result of the contract.

[14] As already indicated, it is not clear on the record before me that Ms. Prijatelj was an officer of Exide. Therefore, the issue of the remedy against her is one that must be the subject of a trial.

CONCLUSION

[15] For these reasons an order will go setting aside the contract between Exide and Ryad dated May 24, 2002 and directing that Lorne Hilts account to Exide for any profit or gain realized by him as a result of this contract. The issue of the appropriate remedy against Ms. Prijatelj and Ryad is referred for trial.

[16] The parties may make submissions to me in writing on the question of costs within 10 days of the release of these reasons.

SACHS J.

Released:

COURT FILE NO.: 02-CV-238804CM1
DATE: 20051101

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

EXIDE CANADA INC.

Plaintiff

- and -

LORNE HILTS, MARGARET PRIJATELJ,
MONTEZ RASOOL and RYAD LOGISTICS INC.

Defendants

AND BETWEEN

RYAD LOGISTICS INC.

Plaintiff by Counterclaim

- and –

EXIDE CANADA INC. and EXIDE
TECHNOLOGIES

Defendant by Counterclaim

REASONS FOR JUDGMENT

SACHS J.

Released: November 1, 2005

2005 CanLII 40363 (ON SC)

2005 CanLII 40363 (ON SC)

TAB 4

McAteer v. Devoncroft Developments Limited 2001 ABQB 917

Date: 20011107
Action Nos. 9201-19685, 9201-19753, 9701-04270 & 9901-00905

IN THE COURT OF QUEEN'S BENCH OF ALBERTA
JUDICIAL DISTRICT OF CALGARY

BETWEEN:

PAUL McATEER and KINGSWOOD GOLF & COUNTRY CLUB DEVELOPMENTS CORPORATION, KINGSWOOD GOLF & COUNTRY CLUB DEVELOPMENTS LIMITED PARTNERSHIP, KINGSWOOD GOLF & COUNTRY CLUB LTD. and KINGSWOOD GOLF & COUNTRY CLUB LIMITED PARTNERSHIP

Plaintiffs

- and -

DEVONCROFT DEVELOPMENTS LIMITED, MARTHA G. BILLES, NEWMAT DRILLING (WESTERN) LTD. and MARTHA G. BILLES, J. MICHAEL LAVERY, and KENNETH W. MANN as TRUSTEES of the “MURIEL G. BILLES ESTATE TRUST FOR OWEN G. BILLES”, the said MURIEL G. BILLES ESTATE TRUST FOR OWEN G. BILLES, and OWEN G. BILLES

Defendants

- and -

TAYLOR McCAFFREY, and BENNETT JONES

Third Parties

AND BETWEEN:

MARTHA G. BILLES, NEWMAT DRILLING (WESTERN) LTD. and MARTHA G. BILLES, J. MICHAEL LAVERY, and KENNETH W. MANN as TRUSTEES of the “MURIEL G. BILLES ESTATE TRUST FOR OWEN G. BILLES” and the said MURIEL G. BILLES ESTATE TRUST, and OWEN BILLES

Plaintiffs by Counterclaim

- and -

PAUL McATEER

Defendant by Counterclaim

AND BETWEEN:

PAMELA MASON AS TRUSTEE FOR CATHERINE ANNE McATEER,
PAUL WILLIAM McATEER, and SARAH ELIZABETH McATEER,
PAUL WILLIAM McATEER, a minor, by his next friend PAMELA MASON,
SARAH ELIZABETH McATEER, a minor, by her next friend PAMELA MASON and
CATHERINE ANNE McATEER

Plaintiffs

- and -

MARTHA G. BILLES, PAUL MURRAY McATEER,NEWMAT DRILLING
(WESTERN) LTD., MARTHA G. BILLES, J. MICHAEL LAVERY and
KENNETH W. MANN as trustees of the “MURIEL G. BILLES ESTATE TRUST FOR OWEN
G. BILLES”, and OWEN G. BILLES,

Defendants

- and -

TAYLOR McCAFFREY, BENNETT JONES and PAUL McATEER

Third Parties

AND BETWEEN:

PAMELA McATEER as trustee for Paul McAteer Junior,
Catherine McAteer and Sarah McAteer

Applicants

- and -

MARTHA G. BILLES, NEWMAT DRILLINGS (WESTERN) LTD.,
MARTHA G. BILLES, J. MICHAEL LAVERY and KENNETH W. MANN,
(in trust for The Muriel G. Billes Estate Trust for Owen G. Billes) and
DEVONCROFT DEVELOPMENTS LTD.

Respondents

AND BETWEEN:

PAMELA MASON, in the name of and on behalf of
DEVONCROFT DEVELOPMENTS LIMITED

Plaintiff

- and -

MARTHA G. BILLES and PAUL McATEER

Defendants

- and -

TAYLOR McCAFFREY, BENNETT JONES and PAUL McATEER

Third Parties

REASONS FOR JUDGMENT
of the
HONOURABLE MR. JUSTICE JOHN D. ROOKE

APPEARANCES[1]:

L.P. Lannan
for McAteer, Kingswood *et al*

J.E. Davison, Q.C.
for Mason *et al*

J.T. Eamon, M.L. Froese & W.E. Code, Q.C.
for Billes, Trust, Newmat *et al*

G.F. Scott, Q.C.
for Bennett Jones Verchere

C.J. Cichy
for Taylor McCaffrey

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[1] It is to be noted that Counsel for all parties, except the Third Parties, represented several individual or corporate parties. However, for ease of reference herein, they will be described as Counsel for their primary clients, as I have perceived it.

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APPENDIX I

APPENDIX II

REASONS FOR JUDGMENT OF THE HONOURABLE MR. JUSTICE JOHN D. ROOKE

I. INTRODUCTION

[1] This case has all of the trappings of a great novel - a loving family corporation developing a golf course and residential project, the introduction of a wealthy female investor, a family broken apart by an affair between the investor and the husband/father, a marriage proposal and cohabitation of the ex-husband and the investor, a divorce, high finance, empire building, corporate intrigue, lack of business and personal faith, termination of the personal relationship and engagement, insolvency, receivership/bankruptcy, and ultimately litigation. However, the factual and legal issues in these consolidated actions are much more mundane

than most of that. They concern duties of directors and shareholders, the validity of loan security, the causes of default and insolvency, the ability to execute on the loan security, and the resulting consequences. There are many pieces to the litigation puzzle.

[2] The story evolves around the shareholdings and assets of a company known as Devoncroft Developments Limited ("DDL" or "Devoncroft"[2]). The primary projects of DDL were the development of an 18 hole golf course at LaSalle, Manitoba, a 172 residential lot subdivision around the golf course, the construction and operation of a golf dome (the "Golf Dome") in Winnipeg, Manitoba, and an apartment complex in Red Deer, Alberta.

[3] DDL[3] owned 100% of the partnership units in a limited partnership, Kingswood Golf & Country Club Developments Limited Partnership ("KDLP" or "Developments LP"), formed in 1987 (Exhibit 2[4]) which owned the back 9 holes (the "back 9") of a golf course, known as the Kingswood Golf & Country Club (KGC), and 89 residential lots, at LaSalle, Manitoba (near Winnipeg), and the Golf Dome. DDL also owned 50% of the partnership units in a limited partnership, Kingswood Golf & Country Club Limited Partnership ("KCLP" or "Club LP"), also formed in 1987 (Exhibit 3), which owned the front 9 of KGC (and had a licence from KDLP to operate the back 9) and lands which subsequently became 83 residential lots (for a 172 total). Those partnerships were managed respectively by the General Partners, Kingswood Golf & Country Club Developments Corporation ("KD", or "Developments", or, as General Partner, "KDGP" or "Developments GP"), and Kingswood Golf & Country Club Ltd. ("KC", or "Club", or, as General Partner, "KCGP" or "Club GP")(collectively all were known as the "Kingswood Group" or the "Kingswood Entities"). Paul McAteer ("McAteer")[5] owned 100% of the shares of KDGP and KCGP. Others owned the remaining 50% of the units of KCLP.

[4] Substantially unrelated to the main issues in this litigation, DDL also owned 50% of the shares of a company called Home at Last Ltd. ("HAL"), which owned a 32 unit apartment building in Red Deer, Alberta, known as "Sunnybrook Courts". DDL, during part of the

[2] There are so many different entities in this case that it was prudent to have a common "List of Acronyms and Definitions" agreed to by all parties (Exhibit 305). I will generally follow those and add more. Indeed, for consistency I shall also substitute them for the fuller names used in quotes from Counsel.

[3] There are a number of transactions over time leading to the resulting ownership outlined in this paragraph, the details of which are on the record. However, as with numerous pieces of evidence relating to the Kingswood Entities, and others -- I find they need not be referenced in any detail in these Reasons.

[4] When reference is made to an exhibit it is often not just referenced to the exhibit itself, but also the oral testimony respecting it, which is of relevance.

[5] To save space and to maximize consistency, I have used the last names only of the parties and the witnesses in both my reasons and in quotations from Counsel. Additionally, the use of the names of the parties may include Counsel on their behalf - e.g., "McAteer argued", rather than "Counsel for McAteer argued".

relevant times, also owned a participation profit interest (flowing from a consulting contract negotiated between Martha G. Billes ("Billes") and McAteer - Exhibit 308) in the development of 3 subdivided lots known as Lands End[6] in North Saanich, on Vancouver Island.

[5] Much of the ownership structure (at the time of the subsequent receivership of DDL) is set out in the Organization Chart of Related Entities (Exhibits 183 and 186 (internal exhibit 3 of the latter)). Additionally, the ownership of some of the entities related to Billes in 1994 (albeit changing over time) was set out in Exhibit 247.

II. EVIDENCE/FACTS, ISSUES AND PARTIES/WITNESSES

[6] The evidence in this case, both orally and by exhibits, was substantial. The Agreed Statement of Facts (Exhibit 283), attached as Appendix I hereto, was 12 pages. There were 481 exhibits entered. The transcript of the proceedings was over 3,200 pages in length. Additionally, a consolidation of the written arguments of Counsel was approximately 350 pages in length (without footnotes and other supporting references), and over 100 authorities were submitted.

[7] Many of the facts that result from that evidence are not in dispute. However, while most of the evidence (and resulting facts) was very helpful in providing a detailed background for the litigation, I find that much of it was not specifically germane to the issues before me, the findings and conclusions to which I have arrived, or the decisions I have made. Indeed, one of the difficult tasks in preparing these Reasons has been to separate out the evidence and facts that are truly necessary for the Judgment, from those that only constitute background, or have more peripheral relevance. Moreover, some pieces of evidence (and resulting facts) relate to issues that are alive in the pleadings but do not need to be considered in light of the conclusions to which I have come. In the result, I have generally tried to limit these Reasons only to the evidence and facts necessary to the Judgment, and the reader's understanding of it.

[8] It is difficult to discuss the issues until the facts are known. However, it is equally difficult to understand the relevance of the facts until the issues are stated. In an effort to organize the evidence and facts that I find relevant and material to the decisions I have made, I will proceed to: state the principle issues; outline the general facts; set out the litigation issues in more detail; and chronicle the more detailed evidence and facts that relate to both, and analyse same. While I will attempt to leave the majority of my findings until later in these Reasons, some will be highlighted early in these Reasons or recorded as the events unfold.

[9] With this understanding, the principal issues (which I will describe below in more detail) include:

[6] Or Landsend, or Land's End - various spellings were used in the documentation; I will use the spelling from Exhibit 308.

(a) did Billes have a duty to disclose (primarily to Pamela Mason ("Mason"), but also to McAteer), and, if so, did she disclose, her interest in the Muriel G. Billes Estate Trust for Owen G. Billes ("Estate Trust" or "Trust") and Newmat Drilling (Western) Ltd. ("Newmat") (collectively the "Lenders"), each of which loaned funds ("Trust Loan" and "Newmat Loan") (collectively, the "Loans"), at her behest, to DDL;
(b) is McAteer implicated in any failure by Billes to make adequate disclosure;
(c) if she failed to disclose, are the Loans to DDL enforceable;
(d) was Billes and/or McAteer guilty of oppression *vis-à-vis* Mason;
(e) was DDL disadvantaged by the actions of Billes and/or McAteer such that DDL is entitled to relief against them;
(f) if Billes is liable on any of these matters, does she have a right to claim therefor against McAteer, or Counsel who prepared the loans, Bennett Jones Verchere ("Bennett Jones" or "BJ") or Taylor McCaffrey ("Taylor McCaffrey" or "TM")(the latter two, collectively the "Third Parties", although McAteer is also a third party in all three of the actions);
(g) does McAteer have any liability to Mason;
(h) is McAteer liable under his guarantee to Newmat ("McAteer Guarantee"); and
(i) what, if any, remedies are appropriate.

This is merely a thumbnail sketch of some of the more major issues which are considered in the Reasons that follow.

[10] This process has been greatly assisted by Counsel agreeing, after consultation, to follow a single outline for written argument ("Outline for Argument")(Exhibit M), which I will in large part attempt to follow in these Reasons. In that outline issues were posed in the form of questions to which Counsel responded. In these Reasons, I will, from time to time, set out the way in which an issue was articulated. I should note that similarly worded issues were stated separately as to the Trust Loan and the Newmat Loan. However, the parties often responded to the issues related to the Trust Loan, and merely referred the reader back to those arguments when addressing the Newmat Loan, except when there was a material difference. These Reasons have adopted that format. In some cases, however, the issues have been combined in a different order to avoid repetition. In others, the issues have not been addressed as they were not considered by Counsel to merit any, or any new, response. Accordingly, I have not addressed every issue set out in the original Outline for Argument.

A. General Facts

[11] In the Outline for Argument, Counsel were asked to focus, as I will attempt to do, on the "chronological dates and events that are key to some finding of fact that is pertinent to an argument being made", as opposed to those which merely provide background or a historical narrative. The material that relates to these latter matters can still be found in the Agreed Statement of Facts and elsewhere on the record.

[12] The Agreed Statement of Facts and Documents (Exhibit 283) identifies the various players (including those active in the issues herein and others), and the basics of the transactions and actions taken relevant to this litigation. It also sets out other transactions and actions that, while not specifically germane to the issues herein, form further background. The Agreed Statement of Facts (modified in some respects to conform to the terminology used in these Reasons) is appended as Appendix I. However, it may be helpful to restate the essence of the relevant, general facts in narrative form.

[13] From November 1987, the McAteer/Mason family owned DDL. In 1990, they sought an investor to inject funds into DDL to allow it to continue its development of the Kingswood golf and residential project. McAteer was introduced to Billes in January 1990, and relatively shortly thereafter, she invested in DDL. Her investment was based on a written proposal by McAteer, dated February 5, 1990. That document consists of over 140 pages of proposal, financial information, projections, asset summaries, sales brochures, appraisals (as at 1987), McAteer's resumé, and corporate records (Exhibit 10). Prior to investing, Billes consulted with Michael Lavery ("Lavery"), a partner in the chartered accounting firm of Deloitte & Touche ("Deloittes"), who conducted the "due diligence" on behalf of and on the instructions of Billes. On April 23, 1990, Billes invested $750,000 into DDL and in return became a 50% shareholder, with McAteer holding 10% and Mason holding 40%, in trust for Paul McAteer Junior, Catherine McAteer and Sarah McAteer (the "McAteer/Mason children"). Billes and McAteer became the sole directors and officers. This investment and purchase of shares was pursuant to an agreement between the parties, dated March 1, 1990, which also reflected the way in which McAteer would operate within DDL thereafter (Exhibits 12, 12A (also 278) and 13A).

[14] As part of the Billes investment, the three shareholders and DDL entered into an Unanimous Shareholders Agreement ("USA")(part of Exhibit 9, and Exhibit 13), the relevant terms of which will be delineated in more detail *infra*, but which provided, *inter alia*:

> (a) unanimous consent of the directors for any indebtedness of more than $500,000 in the aggregate;
> (b) disclosure in writing of the nature and extent of any material interest a director held in any entity which was a party to a proposed material contract with DDL;
> (c) directors abstain from voting to approve a contract in which that director had a material interest;
> (d) a contract in which there was any material interest was neither void nor voidable by reason of such a relationship, if the director disclosed the interest as required and the contract was approved by the directors or shareholders as required and it was reasonable to DDL at the time; and
> (e) if, due to the conflict of interest, 50% of the directors were disqualified from voting, the matter would be decided by a resolution of the shareholders.

Billes had advice from Lavery with respect to the USA, as well as independent counsel prior to its execution.

[15] In July 1990, the financial position of Developments LP improved by $934,000, by a write-down of that amount on the $1,330,000 so called “MECI loan” from MECI Properties, the payout of the difference of which was financed through a loan known as the McLarty Loan (Exhibits 14, 15, and 37B).

[16] An affair between McAteer and Billes was disclosed to Mason on October 23, 1990, and McAteer and Mason separated. A formal separation agreement, which was prepared by BJ, was executed on December 21, 1990 (Exhibit 28). McAteer and Mason were divorced on January 29, 1991.

[17] McAteer and Billes bought a home (the “Wolfe Street property”) together in Calgary and on November 24, 1990 commenced cohabitation. On December 23, 1990, Billes and McAteer entered into a “Domestic Agreement” (Exhibit 21), in which McAteer acknowledged that Billes “had made full disclosure of her financial circumstances”. McAteer confirmed this at trial during cross-examination (“cross”) by Billes’ Counsel, although he denied it in examination-in-chief (“chief”).

[18] In the fall of 1990, McAteer was attempting to secure additional financing for the purposes of developing the back 9 and the Phase II residential development lands of the Kingswood Entities at La Salle. McAteer asked Billes to introduce him to various bankers for this purpose and Billes did so.

[19] During this time Mason and Billes met privately on two occasions, and with McAteer on at least two other occasions, at which Billes alleges DDL business was discussed. Billes testified that during these conversations she disclosed her involvement in the Trust and Newmat to Mason and Mason approved. Conversely, Mason says Billes’ interests and involvement in the Trust and Newmat were never disclosed to her verbally or in writing, until over a year after the execution of the Loans, namely on or after October 9, 1992.

[20] The first of these meetings between Billes and Mason was on December 1, 1990, when Billes and Mason met for lunch at the Westin Hotel in Calgary. Billes, in cross, recalled this meeting being in November, but did not dispute the December date. Mason testified that no DDL business was discussed at that lunch. Rather, the only purpose and subject of discussion concerned how they would handle Christmas with the Mason/McAteer children.

[21] Billes lent $54,000 to DDL on February 4, 1991 (Exhibit 288). There was written disclosure of Billes’ interest and written consent was provided by Mason and McAteer. This disclosure and consent is significant, because Billes indicated that her Winnipeg lawyer, Mr. Lawrence Steinberg (“Steinberg”), told her she needed it in order to comply with the terms of the USA. This demonstrates her knowledge of the necessity for disclosure and consent in circumstances where she had an interest in a loan to DDL.

[22] Billes, Lavery and Kenneth W. Mann (“Mann”), were the Trustees of the Trust, which was created by Billes’ mother’s (Muriel G. Billes) Will (Exhibit 1), for the benefit of Billes’

son, Owen Billes. None of the Trustees had any beneficial interest in the Trust, and Billes was not entitled to any compensation as a Trustee (Exhibit 6). In exchange for security, and under documentation (Exhibits 37, 472 and 473) dated March 21, 1991, prepared by BJ, the Trust loaned and fully advanced $1,200,000 to DDL (the Trust Loan). The purpose of the Trust Loan was to enable KDLP to complete the development of the back 9 holes.

[23] The closing documentation for the Trust Loan included an Officer's Certificate (Exhibits 36, 37 and 39) dated March 21, 1991, wherein McAteer certified that there was no USA preventing the transaction and that all internal documentation by DDL was in order (see below for more detail).

[24] A certified copy of a director's resolution dated March 21, 1991, was executed by McAteer (Exhibits 36 and 37), certifying that a resolution authorizing the borrowing had been passed by the directors of DDL on March 21, 1991. However, there was, in evidence, no actual, executed directors' or shareholders' resolution to that effect. Additionally, both Billes and McAteer signed a technically accurate, but misleading, Certificate of Incumbency (Exhibit 37, Tab 23) which provided that:

> There has been no change made in the Articles of Incorporation or By-Laws of the Corporation thereof which would affect the borrowing power of or the powers to grant security by the Corporation...

It is misleading because, as they both knew, the USA provided (in article 9.02) that there could be no borrowing in excess of $500,000 in the aggregate without the unanimous approval of the directors.

[25] The Partnership Units in the Kingswood Entities held by DDL were pledged to the Trust as part of the Trust Loan security (Exhibit 37, Tab 4).

[26] While she did not initially recall it when asked in cross, Mason's diary recorded that on March 26, 1991, McAteer and Billes attended at Mason's home "for tea". Mason did not recall any DDL business being discussed on that occasion. McAteer testified that no business was discussed. Billes testified in chief that McAteer would often bring her and Mason "up-to-date on business activities over a cup of tea", but that she had no recollection of that date. However, a short time later while still in chief, she was quite definite and specific that the Trust Loan was discussed on that occasion and that Mason was "pleased".

[27] Billes testified that she and McAteer had a discussion about the Trust Loan with Mason in Mason's home when McAteer was doing some renovations, but no date was specified. Mason testified that such renovations had begun in 1990 and continued into 1991, but she had no recollection of any such discussion.

[28] On April 18, 1991, Developments Corp. entered into an agreement to purchase a Golf Dome "skin" package for $600,000 (Exhibit 330). Developments Corp. also continued with

steps to negotiate for land and took other steps which resulted in additional costs of $180,000 being incurred to April 30, 1991 (Exhibit 333, page 10 and Exhibit 47a). The Golf Dome went into operation in Winnipeg, in December 1991.

[29] On April 23, 1991 (a month after the Trust Loan execution), Mason and Billes had lunch at the "Dock" restaurant in Glenmore Landing, in Calgary. Mason testified that absolutely no DDL business was discussed. Rather, the discussion related to the upcoming summer plans whereby the Mason/McAteer children would travel to Billes' cottage in Ontario. The latter was corroborated by Mason's diary entry (Exhibit 289). Billes, on the other hand, testified that she and Mason discussed the Trust Loan and the fact that it had been completed to finance the golf course development. Billes also gave evidence that she told Mason that, unlike the February 4, 1991 loan, there was no need for Mason's approval because Billes had no interest in the Estate. However, as will be seen *infra*, this differs from her claim that she did not want to discuss it with Mason.

[30] Newmat was a company in which Billes was one of three directors (but not an officer) and owned 49% of the shares through her 100% owned and directed company, Marlore Enterprises Ltd. ("Marlore"). At Billes' behest, Newmat, in exchange for security (including the McAteer Guarantee by McAteer - Exhibit 63) and under documentation dated October 10, 1991, prepared by TM, loaned and fully advanced $2,100,000 to DDL (the Newmat Loan). Those funds were borrowed by Newmat from the Province of Alberta Treasury Branches ("ATB")(Exhibit 60), and, from Newmat's side, were authorized by, *inter alia*, the consent of the shareholders of Newmat on October 8, 1991 (Exhibit 369), and directors' resolutions (Exhibits 61 and 62). The supporting documentation was prepared by Newmat's Counsel, Charles Spence, with the firm Miles Davison McCarthy.

[31] As part of the negotiations leading up to the Newmat Loan, its face amount was increased by $200,000 from that originally intended. The additional $200,000 loaned (the "$200,000 Loan") was paid to McAteer in reduction of his DDL shareholder's loan and in settlement of McAteer's ownership claim in the Wolfe Street property. Accordingly, Billes released her security against McAteer's shareholder's loan (Exhibits70, 71, 377, and 455) on October 31, 1991. McAteer moved out of the Wolfe Street property to Winnipeg to devote full time and attention to the DDL/Kingswood business interests.

[32] In the Newmat Loan (as in the Trust Loan), McAteer executed for Counsel, on January 6, 1992, an Officer's Certificate (Exhibit 77) on behalf of DDL. The Officer's Certificates in both the Trust Loan and the Newmat Loan provided, *inter alia*, in paragraph 5 (of each[7]):

[7] In identical wording, except that the Trust Loan Officer's Certificate uses the word "Company" and "We" in paragraph 4, and the Newmat Loan uses "Corporation" and "I" in paragraph 4. Indeed, David Marshall, Counsel at TM who prepared the document for the Newmat Loan, testified he had received a copy of Exhibit 39 from Wayne Whitlock at BJ, who prepared the document for the Trust Loan, and it was used as a precedent for Exhibit 77.

> The Company/Corporation is not bound by any provision in its articles or by-laws or by any unanimous shareholder agreement which would in any way hinder or restrict the powers of the Company/Corporation or the officers of the Company/Corporation to authorize, execute and deliver the Debenture or which would hinder or restrict the Company/Corporation from performing its obligations hereunder.

[33] Also on January 6, 1992, McAteer executed a certified copy of a Resolution of Directors (Exhibit 76), certifying that such a resolution had been passed by the directors of DDL on October 10, 1991 (an executed copy by each of McAteer and Billes appears in Exhibit 306).

[34] The McAteer Guarantee executed on October 10, 1991 by McAteer in favour of Newmat (Exhibit 63)[8] was for the sum of $1,950,000 plus interest as set forth in the Newmat Loan Agreement (Exhibit 67). The Loan Agreement provided for interest at the ATB Prime Rate on commercial loans, plus 2 ½ %, compounded annually.

[35] In 1992, the financial situation of DDL and the Kingswood Entities deteriorated, prompting McAteer to seek a reduction in interest rates on the Trust Loan (Exhibit 85a) and from other secured creditors (e.g. Exhibit 355 regarding the Tess McLarty Debenture).

[36] In July 1992, the McAteer/Billes personal relationship formally ended, having been under strain since September 1991. McAteer testified that their plans for marriage and engagement were terminated at about that time, but Billes testified that it really ended in March, 1991. There was significant tension between the two thereafter: see, *inter alia*, Exhibits 107, 109, 114, 116 - 119, 124, 130, 135 and 309. In fact, McAteer noted in a September 16, 1992 letter to Larry Newel ("Newel"), President of Newmat (Exhibit 127), "you are probably aware that the lines of communication are still down between Martha and myself". In his letter of September 29, 1992 to Rob Desbarats ("Desbarats") (Exhibit 134), McAteer indicated further that he had made seven proposals for resolution of the impasse between him and Billes between March 24, 1992 and July 30, 1992, but had no "specific acknowledgement or response" from Billes (see also references to this in TM's letter of October 5, 1992 - Exhibit 136). In the September 29 letter he also raised the issue of Billes' conflicts.

[37] In the period from August 1 to October 13, 1992, it appears that Len Sali, Q.C. ("Sali"), a partner at BJ, was retained by Billes, and possibly one or more of the Trust, Newmat and Owen Billes, in connection with the Loans. He and Billes met with McAteer and Mason on October 9, 1992. This meeting and its significance will be discussed *infra*.

[38] During this period McAteer continued to try to find a solution to the cash problem that DDL was experiencing. His attempts included his November 12, 1992 proposal (Exhibit 145)

[8] This Guarantee is relevant to the Newmat counterclaim against McAteer. No evidence or argument in defence of it (directly) was raised before the Court.

for a shareholders meeting for December 4, 1992 “to attempt to remedy the current financial problems”.

[39] The Lenders demanded their loans (and guarantees) on, *inter alia*, November 17 (Exhibit 152, seeking interest of $104,278, under the Newmat Loan) and November 23, 1992 (Exhibit 167 as to $1,278,571 owing under the Trust Loan, Exhibits 168 and 169 as to $2,204,424 owing under the Newmat Loan, Exhibit 170 as to $2,054,423 under the McAteer Guarantee of the Newmat Loan, and Exhibit 171 as to $1,574,140 owing under the mortgage by Developments G.P. to 2809291 Manitoba Ltd (“280"), flowing from default of the Newmat Loan).

[40] With respect to the action by Mason, in the name of DDL (the “Derivative Action”) (Action No. 9901-00905), the parties agreed on a deemed action date of November 24, 1998. Consequently, any allegations based on facts occurring before November 24, 1992, would be barred by any applicable six year limitation period.

[41] DDL was placed in receivership by the Lenders on November 27, 1992 (Exhibits 173 and 176 as to the Trust, and Exhibit 177 as to Newmat), and Sill Streuber Fisk Inc. (“Sill”) was appointed as a private receiver and manager pursuant to the Lenders’ security.

[42] Other security was enforced, including: Royal Bank (balance of the Phase I residential lots); McLarty ($500,000 - Exhibits 17 and 25); Harry Enns (back 9); and Owen Billes ($175,000 on the Phase II Development Lands - Exhibits 20 and 441), transferred to the Estate Trust in 1994 (Exhibit 368). Of particular interest, Harry Enns enforced his security on the back 9 of KGC which was sold to a third party by auction pursuant to mortgage proceedings in Manitoba. Subsequent negotiations led to Billes related entities purchasing the back 9 from the third party, thus consolidating the 18 holes.

[43] On November 30, 1992, the first action (“McAteer/Kingswood Action”) in this litigation was commenced by McAteer and the Kingswood Entities.

[44] On December 5, 1992, a Stand Still Agreement was signed (Exhibit 179) and Sill was instructed to prepare a business report. Sill delivered interim reports on December 18, 1992 (Exhibit 180) and February 4, 1993 (Exhibit 181), and its formal Business Report on March 31, 1993 (Exhibit 186).

[45] On April 19, 1993, Notices of Intention to Enforce Security were issued under the Lenders’ Loans (Exhibits 188-190).

[46] Kingswood Club LP, Club GP, Developments LP and Developments GP gave Notice of Intention to Make a Proposal in bankruptcy on May 3, 1993 (Exhibit 196). Peat Marwick Thorne Inc. (“KPMG”) was appointed interim receiver by the Court of Queen’s Bench of Manitoba on May 7, 1993 (Exhibit 202) and Receiver and Manager on May 28, 1993 (Exhibits 211, 214 and 215). KPMG was also appointed receiver under the Trust Loan debenture on

May 28, 1993 (Exhibits 206 and 211). All voluntarily assigned themselves into bankruptcy on May 19, 1993, effective May 3, 1993, with Ernst & Young as Trustee (Exhibits 212 and 213). No formal proposals to address financial or operational conditions were ever received from any source.

[47] On December 10, 1993, the Lenders (Exhibit 226) advised Mason and McAteer that HAL had been struck from the Corporate Record in 1992 (Exhibit 175[9]), was suffering financial losses and was in need of funds. The Lenders proposed to purchase DDL's 50% holding in HAL for $7,500 if Mason and McAteer did not wish to purchase same (Exhibits 226 and 226A). Mason and McAteer did not respond to this offer.

[48] In December 1993 and January 1994, real estate appraisals were obtained which valued the Golf Dome at between $629,000 - 650,000.

[49] On January 24, 1994, the assets of KCLP secured to the Trust, being the front 9, were foreclosed to the Trust by the Order of Justice Wright of the Manitoba Court of Queen’s Bench (Exhibit 244). The Order provided that the foreclosure satisfied the entirety of the debt owing by DDL to the Trust. Mason unsuccessfully sought a stay of the application. McAteer unsuccessfully requested the Court to reconsider its decision, and an appeal of this Order by McAteer was subsequently abandoned (Exhibits 244, 249 and 253).

[50] On March 18, 1994, the Lenders provided notice to Mason and McAteer with respect to the sale of the Golf Dome (Exhibit 269).

[51] Between March 25 and November 1, 1994, various transactions took place that flow from the execution on the Lenders’ security, including the following (largely as described by Mason):

> (a) March 25, 1994 - 3038319 Manitoba Ltd. (“303"), a wholly owned subsidiary of Albikin Management Inc. (“Albikin” - solely owned by the Martha Billes Family Trust, and directed and operated by Billes, Newel and Owen Billes until January 31, 1994, when Owen Billes remained the sole director - Exhibit 365), purchased the Golf Dome from Newmat nominee, 2809291 Manitoba Ltd. (“280"), for $648,000 (Exhibit 246);
> (b) May 1, 1994 - the Trust purchased the Owen Billes mortgage from Developments Corp. for $175,000 (Exhibit 368);
> (c) June 14, 1994 - 3138993 Manitoba Ltd. (“313"), a wholly owned subsidiary of the Trust (directors being Billes, Owen Billes and Newel - Exhibit 442), entered into an agreement with 3111296 Manitoba Ltd. (“311" - owned by Gary and Wayne Curtis (“the Curtises”)) to sell the front 9 and back 9 of the Kingswood Golf Course for $1,225,000.00 - the transaction closed September 15, 1994 (Exhibits 268 and 366);

[9] HAL was subsequently revived in November 1993 (Exhibit 225).

(d) October 24, 1994 - Owen Billes became, and Billes resigned as, a director of Billog Corporation Ltd. ("Billog") (Exhibit 364);
(e) October 24, 1994 - Newmat and Billog entered into an agreement whereby Newmat funded $7,500 to Billog to purchase the HAL shares from Sill, as Receiver Manager of DDL, and agreed to make ongoing advances as necessary. Billog and Newmat agreed to split the sale proceeds 60% to Newmat and 40% to Billog (Exhibit 424);
(f) October 25, 1994 - DDL (by Sill) sold Billog all DDL's shares in HAL plus all amounts owing to DDL by HAL for $7,500.00 (Exhibit 267 - also Exhibit L); and
(g) November 1, 1994 - Newmat and 303 entered into an agreement whereby Newmat agreed to provide consulting services to 303 in respect of the Golf Dome, the agreement being retroactive to November 1, 1993 (Exhibit 426).

[52] DDL was struck by the Registrar of Corporations in November 1994, and revived formally on January 19, 1999, for the purposes of this litigation. It was never placed into bankruptcy.

[53] As at January 16, 1995, all of the assets of DDL had been the subject of disposition (Exhibit 271).

[54] In August 1995, HAL's property in Red Deer was sold for a total price of $1,050,000.00 (Exhibits 343 and 350). The net sale proceeds of $99,667 (Exhibit 424) were distributed amongst HAL shareholders, including Billog. Newmat and Billog subsequently entered into a further agreement on April 14, 1997, whereby Newmat agreed to manage funds received by Billog from the sale of HAL (Exhibit 425).

B. Litigation Issues

[55] The plethora of facts alleged in the pleadings, many of which are diametrically opposed, present a complex matrix of issues. The Record, amended to April 17, 2000 (Exhibit 285), consists of some 30 separate, relevant pleadings and documents. In this section I have attempted to summarize, albeit with the broadest of brushes, the primary issues.

[56] The first action in this consolidated litigation, the McAteer/Kingswood Action (Action No. 9201-19685), was brought by McAteer and the Kingswood Entities against DDL, Billes, Newmat, the Trust and Owen Billes (the latter four, or Billes, or any one or more of them also being referenced herein as "Billes *et al.*[10]). The McAteer/Kingswood Action alleged, *inter alia*, that Billes, being a director, officer and shareholder of DDL, was also a director, shareholder (through Marlore) and an officer and the controlling mind of Newmat. It alleged further that Billes was a Trustee, and the controlling mind of the Trust. The Plaintiffs claimed that, contrary to the USA and the Alberta *Business Corporations Act*, S.A. 1981, c. B-15 (the *"ABCA*"), Billes failed to disclose her interest in the Loans. It also alleged that Billes and

[10] Where I merely make reference to "Billes", when the reference should be to "Billes *et al.*", the former should be interpreted to include the latter.

Newmat, for improper purposes, induced the Plaintiffs not to proceed with a loan from Household Trust, but to proceed with the Newmat Loan. On those bases, the Plaintiffs sought, *inter alia*, a declaration that the Loans be set aside, damages in the amount of $10,000,000 and punitive damages of $1,000,000.

[57] By way of counterclaim in the McAteer/Kingswood Action, ("the Billes/Newmat Counterclaim"), Billes *et al.* alleged that McAteer provided legal advice to Billes in respect of the Loans, and, accordingly, had a duty to ensure they were in accordance with the law. The Plaintiffs by Counterclaim alleged that the Loans were binding obligations. They claimed alternatively that, if the Loans were found to be invalid, losses would be suffered in excess of $5,000,000, plus interest and realization costs, and, accordingly, claimed damages therefor. Newmat alleged McAteer executed a Guarantee for the Newmat Loan in the amount of $1,950,000 plus interest, and sought $2,054,424 plus interest after November 23, 1992.

[58] In Action No. 9201-19753, commenced by way of Originating Notice of Motion, Mason, as trustee for the Mason/McAteer children, sought relief against Billes, Newmat, the Trust, and DDL. The Action alleged that Billes was a beneficial 50% shareholder and a director of Newmat and controlled the Trust. She alleged further that, contrary to the USA, Billes caused Newmat and the Trust to take security over the assets of DDL and the Kingswood Entities, in a way that was in breach of her fiduciary duties and oppressive to Mason, and sought, *inter alia*, leave to bring an action on behalf of DDL (the Derivative Action) and an order directing a trial of the issue of whether any security granted by DDL to Newmat and the Trust was valid. As the allegations in this Originating Notice of Motion are similar to the issues in the Mason Action, and the Derivative Action (as defined, *infra*), I shall deal with them in those actions.

[59] Mason, as trustee and next friend for the Mason/McAteer children, commenced Action No. 9701-04270 ("the Mason Action"), against Billes, McAteer, Newmat, the Trust and Owen Billes, in which she alleged, *inter alia*, that: Billes executed documentation for the Trust and Newmat Loans without declaring her interest as required by the USA and the *ABCA*; McAteer executed false Officer's Certificates for the Loans and permitted DDL to enter into the Loans contrary to the USA; Billes caused the assets realized from DDL in the enforcement of the Loans security to be sold at below fair market value and in a commercially unreasonable manner; Billes and McAteer breached their contractual, legal and fiduciary duties to the Plaintiffs; and the acts and omissions of McAteer and Billes were oppressive, unfairly prejudicial, or unfairly disregarded the interest of the Plaintiffs. On that footing, Mason sought an order for compensatory damages suffered due to the oppressive and prejudicial actions, including general and punitive damages of $10,000,000 and $1,000,000 respectively, and costs on a solicitor-client basis. Billes *et al.* pled, *inter alia*, that this action had been brought out of time and that the issues dealing with the enforceability and validity of the Loans were, because of the Manitoba Foreclosure, *res judicata*.

[60] The Derivative Action of Mason, in the name and on behalf of DDL, in Action No. 9901-00905, permitted by and under the terms of the Case Management Order of McIntyre J.

of January 15, 1999, alleged against Billes and McAteer, *inter alia*, that they, as directors and officers of DDL: breached their contractual, legal and fiduciary duties to DDL to act honestly, in good faith and in the best interests of DDL; failed to comply with the provisions of the USA and the *ABCA*; and failed to manage the affairs of DDL prudently and thereby protect its interests. As a result of the alleged breaches, DDL claimed damages, including general and punitive damages of $10,000,000 and $1,000,000 respectively, costs on a solicitor-client basis, and an order that any amount adjudged payable by the Defendants be paid to Mason in trust for the Mason/McAteer children. Billes *et al.* raised limitation and *res judicata* defences.

[61] Billes *et al.* named BJ, TM and McAteer as Third Parties in all three actions. Indemnity or contribution against the Third Parties was sought in the event that any of the claims against Billes *et al.* were successful.

[62] By Orders dated October 17, 1997 and May 12, 1999, the Case Management Justice, McIntyre J., ordered that all the actions be tried together. The Record for these actions and the pleadings that remain, following numerous discontinuances of other parties, are identified in Exhibit 285.

[63] Thus, the issues between the parties include, in a broad sense: a determination of the validity of the Loans in view of the alleged failure of Billes to disclose her interest in the Trust and Newmat; the complicity, if any, of McAteer in Billes' failure to disclose and the liability (if any) to which this subjects him *vis-à-vis* Mason and/or Billes; whether Billes and McAteer are guilty of breach of contractual, legal or fiduciary duties to DDL and Mason, and whether their conduct is oppressive to Mason; the liability of McAteer to Newmat under the Newmat Loan; the liabilities of BJ and TM if the Loans are invalid; and the remedies that follow from any liability.

C. Parties/Witnesses

[64] A number of the original parties have disappeared through the course of the litigation. The parties that remain are Billes, McAteer (and the Kingswood Entities), DDL (although represented by Counsel only in the Derivative Action), Mason (as trustee for the Mason/McAteer children), the Trust, Newmat, Owen Billes, BJ and TM. Witnesses that are also parties were limited to Billes, McAteer, Mason and Owen Billes. Witnesses who appeared in representative capacities on behalf of parties included: Lavery and Mann, on behalf of the Trust (Lavery also testified in his role as an advisor to Billes); Newel, on behalf of Newmat; David Marshall ("Marshall"), Barrister and Solicitor, on behalf of TM; and Wayne Whitlock ("Whitlock"), Barrister and Solicitor, on behalf of BJ.

[65] Other ordinary witnesses (in order of appearance), who were neither parties nor specific representatives of parties, and how they fit into the story (in a general sense), are set out in Appendix II.

[66] Expert witnesses (in order of appearance) who appeared at the request of parties with specific expertise and for specified purposes[11], and who provided expert reports (some of which are identified below) are also set out in Appendix II.

III. SUMMARY OF THE JUDGMENT

[67] The actions of all Plaintiffs in this case, and the actions by Defendants against Third Parties, are dismissed with costs, except for the Mason Action, the Newmat Counterclaim and Billes' Third Party claim against McAteer in the Mason Action, all to the extent hereinafter delineated.

[68] Specifically, in the Mason Action, Mason shall have judgment, based on the oppression remedy, for $440,000, plus interest from March 21, 1991, and solicitor-client costs, jointly and severally against Billes personally and McAteer personally, but not as against the Trust, or Newmat.

[69] In the Third Party claim against McAteer in the Mason Action, Billes shall have, as against McAteer, indemnification for the judgment against her in favour of Mason for $440,000, plus interest from March 21, 1991, and solicitor-client costs. Additionally, Newmat shall have judgment under the McAteer Guarantee for $1,950,000, less any credits due, plus interest from November 23, 1992, and costs, against McAteer.

IV. STATUS OF THE PARTIES

A. McAteer, Kingswood Group and Unsecured Creditors

[70] In respect of the McAteer/Kingswood Action, an Order was issued by the Manitoba Queen's Bench in Bankruptcy (Exhibits 258 and 310) on April 6, 1994, authorizing McAteer to continue prosecuting the litigation on behalf of the Kingswood Entities and their unsecured creditors in the McAteer/Kingswood Action (a list of such unsecured creditors is attached to Exhibit 310). McAteer testified he served the unsecured creditors with an information circular including the Order and other relevant documents (Exhibit 310). However, in order for the unsecured creditors to participate in the litigation they were required to agree within 7 days of service to contribute (*pro rata* to their claim) to the expense and risk of the proceedings. No creditor unrelated to McAteer has taken such steps. Consequently, any unsecured creditors are not parties to the McAteer/Kingswood Action, or this litigation.

[71] Even if unsecured creditors, other than McAteer, had been participating under the aforementioned Order, they would have no higher rights than the Kingswood Entities and

[11] The primary purpose of their attendance is listed in Appendix II, although some also provided rebuttal evidence to other expert witnesses.

would be subject to all the same defences. Thus, on the decision I have made, they would be entitled to no relief.

B. Other Status Issues

[72] Mason has status to bring the Mason Action on behalf of the Mason/McAteer Children. Additionally, Mason, was also granted authority to commence and prosecute the Derivative Action on behalf of DDL, pursuant to the Order of McIntyre J., dated January 15, 1999 (Exhibit 8). In accordance with that Order, she is entitled to, and liable for, any costs granted to or against the Plaintiff, DDL, such costs to be in the discretion of myself, as the Trial Justice.

V. CREDIBILITY AND ANCILLARY FINDINGS

[73] In coming to my decision in this litigation, I have come to certain conclusions regarding credibility, some of which will be more relevant to factual findings and the result, than others. The parties addressed this topic under the Outline of Argument heading of “Credibility” in response to the question “What considerations should be taken into account on conflicts of evidence (between Billes and McAteer, Billes and Mason, and others) in the context of credibility?”

[74] Before assigning specific individual credibility, I must first note that no witness appeared to have perfect recollection. In that regard, I accept the applicability of Billes’ reference to Virtue J’s. statement in *Colborne Capital Corp.* v. *542775 Alberta Ltd.* (1995), 30 Alta. L.R. (3d) 127 at 182 (Q.B.) (varied for other reasons at 69 Alta. L.R. (3d) 265 (C.A.)):

> It would be surprising if, in a matter as complex and detailed as this, a witness had perfect recall not only for every event, but for the precise date and sequence of its occurrence.

The alleged conflicts and contradictions in the evidence were often on small, collateral points. Given that this trial occurred 10 years after Billes became an investor in DDL, it would not be surprising if many of these contradictions were the result of innocent mistakes in memory. In the result, the conflicts are not always as serious as argued and many of the inconsistencies are relatively inconsequential, or on minor matters.

[75] Further, as noted by BJ:

> (a) there is obvious and understandable rancour amongst and between McAteer, Mason, and Billes and to varying degrees their memories and testimony are likely affected by deep personal feelings;
> (b) each of McAteer, Mason and Billes, have considerable self-interest in the outcome of the litigation, both personally and financially, and it is reasonable to assume that elements of their testimony, to varying degrees, are influenced by this self-interest; and

> (c) some evidence, although not capable of being specifically refuted, appears to offend common sense as to what might be expected of the parties in the circumstances at the time. The Court should utilize considerations of common sense and normal expectations to assist it in deciding amongst conflicting evidence.

I generally agree with these observations, subject to what follows.

[76] The following are indicia that have assisted me in making certain findings of credibility, which in turn, have helped me to make other findings of fact, where the evidence conflicts. I will describe the more important findings in this regard. However, before I do so there are three realities that I wish to raise. One is that findings of credibility and findings of fact are often interwoven, and, accordingly, in determining credibility, I will set out some incidental findings of fact. The second reality is that credibility must be considered in the context of the whole of these Reasons, because the conflicts may be more relevant and apparent when all of these Reasons have been read, and the issues and the substantive findings are made. Finally, on most findings in these Reasons where there is a conflict, I have not ignored statements by witnesses to the contrary, but rather have accepted the ones that constitute my findings.

A. Billes v. Mason

[77] The main area of difference between the evidence of Mason and Billes is as to whether Billes provided information to Mason in respect of her interests *vis-à-vis* the Loans. In this regard, where the evidence of Billes and Mason conflicts, I prefer Mason's evidence for a number of reasons. The most important of these reasons is that I found Mason more candid than Billes, and less motivated by the results sought.

[78] Additionally, Mason made some notes of her and Billes' conversation in some instances, which, generally tend to corroborate her evidence. One such entry related to the "Dock" lunch on April 23, 1991 (Exhibit 289) in relation to which Billes testified, but I do not accept, the Trust Loan was discussed. Even if that were the case, any oral disclosure made on that occasion would have been a month after the Trust Loan and, therefore, too late in any event. Mason's diary tends to corroborate her evidence in that it references discussions relating to personal, not business, matters. Mason acknowledged that the entries were sketchy and that she had not made notes of some other significant items, such as the closing of the original investment by Billes on April 23, 1990, or the meeting with Sali on October 9, 1992, or her discussions with McAteer in August 1992 about the bank line of credit. Billes gave no evidence of making notes of any such meetings.

[79] Further, Billes' evidence was, from time to time, in conflict with her own previous testimony, and often less compelling than that of Mason. For example, as to the March 26, 1991 tea at Mason's house, Billes testified in chief that she had no recollection of that date. However, a short time later while still in chief, following a coffee break, she was quite definite

and specific that the Trust Loan was discussed on that occasion and that Mason was “pleased”. Billes’ change in recollection within a few minutes denotes a lack of credibility.

[80] There was also an entry in Mason’s diary concerning when the two had “tea” with McAteer which indicates that this occurred on March 26, 1991. Mason did not recall what was discussed on that occasion, but testified that it was not a business meeting. I would again note that even if there had been any disclosure made to Mason on that occasion it occurred five days after the Trust Loan and was too late to be legally effective.

[81] In any event, I accept the evidence, corroborated by Mason’s diary, that Mason met (informally over tea) with McAteer and Billes at her home on March 26, 1991, a few days after the Trust Loan was executed on March 21, 1991.

[82] Also of note was Billes’ argument that in March 1991, Billes and McAteer “discussed consent to the Trust loan with Mason, who consented”. However, Billes also argued that “McAteer assured [Billes that] Mason had consented...” I find the latter to be a curious argument if Billes was in fact present when Mason “consented”. Mason and McAteer deny both of these allegations, but there is no corroborating evidence in either direction by which to test the testimony of the parties on the point.

[83] Additionally, Billes testified that in October 1991, she attended at Mason's home on one or two occasions and “made certain Mason was aware of the Newmat loan”. She also stated that McAteer told her that he had told Mason about this loan. However, Mason and McAteer both deny that Mason was told of the Loans.

[84] Another example of inconsistency in Billes’ evidence concerned the $54,000.00 loan made on February 4, 1991. In chief, Billes gave evidence that she discussed the loan with Mason when they had lunch at the Westin some weeks after the consent to the loan (Exhibit 288) was signed. However, in cross, Billes gave evidence that the lunch at the Westin took place on December 1, 1990, some two months before the transaction. Mason says there was no discussion with Billes about this matter at any time. Rather her evidence is that the consent documentation was brought to her by McAteer, at Billes’ request, and that McAteer explained that her signature was required pursuant to the USA, and Mason agreed and signed it. Common sense dictates that Billes’ evidence is incorrect in this regard as this was apparently a matter that arose and was dealt with quickly. The likelihood that it was discussed 2 months before the need arose defies common sense and credibility.

[85] At the October 9, 1992, meeting with Sali, Mason denied any prior knowledge of the Loans. Interestingly, rather than confronting Mason, as would be expected if indeed Billes had previously discussed the Loans with her, in apparent response to this lack of knowledge, Billes provided her with documentation relating to the Loans (the specifics of which are not clear on the record) saying words to the effect: “Here, take these ... papers; and perhaps when you've had a chance to read them, you will understand why I'm so concerned”. Contrary to the evidence of Billes that Mason previously knew of at least the Trust Loan, this statement tends

to corroborate Mason's evidence that she did not have any such knowledge and Billes knew it. Otherwise, there would be little or no need for Billes to have provided the documentation. In her letter of October 12, 1992 (Exhibit 137) that followed this meeting, Mason makes reference to her "need to know the exact nature of these transactions, Martha's interest in them". She also stated "I wonder why it is *only now that I'm learning about all this debt* ... when ... [the USA] states very clearly that my consent was needed before the transactions could even be made" [Emphasis added]. This expressed lack of knowledge, although opportune in timing from Mason's perspective, is consistent with Mason's testimony, but inconsistent with Billes' evidence that she had previously explained the Loans to Mason. Moreover, Mason's position is corroborated by Sali's letter of October 13, 1992 to TM (Exhibit 138), wherein Sali stated "It appears that [Mason] was almost completely unaware of the financial difficulties being experienced by the various business entities...".

[86] However, Billes, and the Third Parties, argue that, given the contact between McAteer, Mason and Billes, it is hard to believe that Mason did not know of the Loans and would not have consented to them if asked. BJ, relying on probabilities and common sense, not evidence, put it this way:

> Given the extent of her children's continued ownership interest in DDL and her not infrequent contact with McAteer, and to a lesser degree Billes, it is improbable that she would be unaware of the fact that ... Billes, in one form or another, was lending money to support DDL and the Kingswood entities. She knew that DDL needed financing to pursue its plans and it offends common sense to believe that she either would not have known of the Trust Loan or would not have willingly consented to it had she been advised.

[87] In response to these arguments, it is not in dispute that Mason knew DDL needed external financing. Nor is it disputed by Mason that, from time to time, McAteer (on one or two occasions with Billes) provided her with general oral information as to progress of, and some of the difficulties with, continued financing for the projects. Finally, it is not disputed that Mason wanted DDL to be a success.

[88] I find that any information provided to Mason was, as Mason described in written argument,"in effect passing comments as McAteer and/or Billes [were] picking up or dropping off children. No meetings [were] held for the purpose of discussing DDL business". Mason's evidence was that any such "conversations were very cursory" and "always given to me in passing", and "there was no specific information given to me at any time in any business sense whatsoever". I accept this evidence. It is also apparent that, as the McAteer/Billes personal relationship soured, McAteer disclosed to Mason some information about his concerns over what he thought was Billes' interference in Royal Bank banking issues in August 1992, about which McAteer wrote to Billes on August 9, 1992 (Exhibit 116).

[89] Also, as alluded to above, the timing of the discussions are relevant as most were after the Loans were made on March 21, 1991 (e.g. the tea on March 26, 1991) and October 10,

1991. Even if I accepted that Mason was generally agreeable to further financing for DDL, that, in itself, would not be conclusive of any issue herein. Further, had I found that Mason knew of the *existence* of the Trust Loan during tea on March 26, 1991, which I do not, it would not be relevant to the findings I have to make. In other words, if there was a discussion *after the fact* concerning Billes' interest or that the transaction had required Mason's consent as a shareholder, it would not assist Billes as I find that consent was never obtained or waived by Mason, nor did she ratify the Loan. Even if there were oral discussions about progress or the mention of a Loan, which I do not find, that is not the same as disclosure of Billes' interests, and Mason's shareholder approval, which were both required in writing by the USA.

[90] In the result, as to these meetings between Mason and Billes prior to October 9, 1992, I find that there were no discussions between them wherein Billes provided Mason with any, and certainly not full and fair, disclosure, oral or written, concerning her relationship to the Trust or Newmat. I find further that Mason did not waive any right to disclosure or any other rights afforded to her under the USA between Billes, McAteer, herself, and DDL.

B. Billes Generally

[91] As to Billes' credibility generally, BJ argued that Billes' confidence in her testimony exceeded the accuracy of her recall of details and that the Court should exercise care in relying on her details of specific events. I believe this is good advice. BJ also argued that, "[w]hile this is not to suggest that the general nature of the evidence was not credible", Billes had a "noticeable tendency to take a series of conversations or events and testify about them as a single event or conversation with a degree of certainty that was not warranted." I agree.

[92] Billes' testimony also conflicted internally. One example of this was when Billes, in cross, denied that she thought of herself as a "venture capitalist", despite that she had described herself as such during examinations-for-discovery ("discovery"). When this apparent contradiction was put to her in cross at trial she stated that she had enjoyed "adventure as a capitalist". This play on words was an obvious effort to avoid an admission of what she had said on discovery. While an unimportant and collateral point at first blush, it is another example where her evidence was incredible. Moreover, her twist of phrase may well have been motivated by the knowledge that something may turn on it - specifically a finding of fiduciary duty on Billes as a lender: see reference to "...Lender involvement in management of the borrower's business, as sometimes practised by 'venture capitalists'", in *Canadian Bank of Commerce (C.I.B.C.) v. De-Jai Holdings Inc.*, [1993] O.J. No. 640 (Gen. Div.), online: QL (OJ), aff'd [1997] O.J. No. 1672 (C.A.), online: QL (OJ).

[93] I note as well Billes' attempts in oral testimony to deflect an issue and thereby contradict positions she took earlier. A case in point is the issue regarding the $200,000 Loan (discussed in more detail *infra*). In argument, Billes summarized her evidence that, *inter alia*, "The increase in the Newmat loan from $1,900,000 to $2,100,000 was to replenish DDL to fund the obligation to pay $5,000/month to McAteer." However, as Mason pointed out, this is contradicted by documentary evidence in Exhibits 67 and 377. Moreover, Billes contradicts it

herself in her letter to McAteer in July 1992 (Exhibit 107) when she said:“DDL is carrying the debt related to the $200,000 payment to you, created when you moved out of 2229".

and a special relationship that grew from that and their personal relationship.

C. Billes v. McAteer

[94] Notwithstanding the observations regarding Billes in the last two sections, where there are conflicts between Billes’ and McAteer’s evidence, I generally prefer the evidence of Billes. As an overview, I would note that much of their testimony was in accord. However, McAteer tended to demonstrate a bravado of confidence in chief, testifying as to copious, intricate details that Billes could not match. Billes’ evidence, on the other hand, was much more general on the conflicting matters that are really in issue. Nonetheless, with some exceptions, I find Billes’ evidence on the whole to be more credible than that of McAteer.

[95] While over inclusive on detail and confident in his chief, McAteer’s testimony in cross, at times could most generously be described as equivocal. His answers on cross were often ambiguous or unclear, giving the impression of attempting to avoid a direct answer, even to the extent of misleading or hedging. A number of examples were provided in written argument by Billes of the differences between McAteer’s emphatic statements in chief, and their dilution on cross, where he, more often than in chief, retreated to use of the less positive “I believe”, or “to the best of my recollection”, etc.. There were also inconsistences between his evidence at trial and his discovery evidence. Some of his evidence was simply incredible, improbable or unbelievable - particularly on those occasions where he tried to explain why he had signed the Officer’s Certificates. On those occasions his answers were misleading at best.

[96] The most germane conflicts between Billes and McAteer related to: (1) his knowledge of the extent of her interest in the Trust and Newmat; (2) whether he had agreed with Billes to advise Mason of the conflict and obtain her consent; (3) whether he had read and knew that the Officer’s Certificates were false; and (4) whether there was a condition precedent to calling the Trust Loan.

1. McAteer’s Knowledge of Billes’ Interest

[97] McAteer and Mason argued that Billes did not disclose in writing her conflict in accordance with the USA and section 115(1) of the *ABCA*. I find that to be true. McAteer argued further that any disclosure Billes made to him in this regard was misleading and insufficient, such that he was unable to make a decision as to her conflict. I find that to be untrue. He submits further that he relied on this lack of disclosure when he signed the Officer’s Certificate in relation to the Trust Loan. Although I will deal with McAteer’s agreement to disclose Billes’ interest in the Trust and Newmat to Mason in this section, I will deal with McAteer’s knowledge of that interest and his ability to provide Mason with disclosure in the following section which deals with “Factual Findings”.

[98] Billes' financial disclosure to McAteer was specifically acknowledged by him, in writing, by the terms of the December 23, 1990 Domestic Contract between them (Exhibit 21, clause 16(c)). Moreover, Billes gave evidence (Transcript page 1583 *et seq*) about her disclosure and the documentation made available to him, relative to that disclosure. Although McAteer admitted this acknowledgement was true in cross, he argued about what it meant. In any event, this admission, in the face of other denials, further diminishes his credibility.

2. McAteer's Undertaking to Billes to Provide Disclosure to Mason

[99] McAteer denies he represented to Billes that he would or did provide written disclosure of Billes' interest to Mason or obtain Mason's consent. I do not accept that evidence.

[100] Conversely, Billes testified that she did make full and fair disclosure to McAteer and asked him to ensure that the matter was properly addressed by way of the required written disclosure and consent by Mason, and the appropriate minutes relative thereto. She testified that McAteer undertook to do so. She argued, relying on *ABCA*, sections 20(a)(b), 20(5), and F.W. Wegenast, *The Law of Canadian Companies* (Toronto: Carswell, 1979) at 437-438, that McAteer was legally obligated to maintain the required directors' and shareholders' minutes in any event, as a result of his position as a lawyer, President and Secretary of DDL, and holder of its minute book. Accordingly, Billes argues that she complied with the USA and section 115.

[101] As to McAteer's undertaking to Billes to disclose her interest to Mason and to obtain the necessary consents from Mason, the confirmation that he had done so and Billes' reliance on that undertaking, I prefer Billes' evidence for a number of reasons.

[102] First, while Billes learned specifically from Steinberg of the need for consent from Mason in February 1991, at the time of the $54,000 loan, it was McAteer who obtained Mason's signature. This is reasonable, having regard to the apparent continued cordial Mason/McAteer relationship as parents of their children, notwithstanding their divorce.

[103] As to obtaining Mason's signature in relation to the $54,000 loan, and the need for Mason's acknowledgment of disclosure and consent to the Loans, Billes testified:

> At that time when I met with Mason she was upset that in the past I had asked for her sign-off on the $54,000 lot purchase loan which had come a month or so before the estate loan, and when we started talking about assurances regarding the estate trust loan that she felt -- she was upset that I was asking for her signature. She said we're in this together, there's no need for a signature so that I did not ask her for a signature on that loan. I did not ask her for a signature on this loan.

> I did ask McAteer to make sure that there were minutes in the DDL closing book at the time ...of the estate loan and he assured me that there would be; that the shareholders had concurred at an *ad hoc* gathering of the shareholders at DDL. So I didn't want to enter that arena again on the signature side *even though I knew there was possibly a conflict here*, so I had it dealt with again by the lawyers and I only spoke verbally with Mason. [Emphasis added.]

[104] I do not accept Billes' evidence that she spoke to Mason about any of these loans or asked for her signature. Rather, I find that it was McAteer who obtained Mason's signature in relation to the $54,000 loan and Billes neither discussed that loan nor the Trust or Newmat Loans with Mason. I find further that Mason was not upset about signing off on the $54,000 loan - she never gave any hint in her testimony to this effect, and I do not believe such a suggestion was ever put to her in cross. Accordingly, I do not accept Billes' evidence that the reason she did not ask Mason for her signature on the Loans was because Mason was upset. I am not certain whether by using the term "*ad hoc*" she means "round robin" or the normal meaning of the phrase. In any event, I do not find that there was any "*ad hoc*" meeting of or signature by the shareholders, although I accept that is what McAteer may have told her.

[105] Second, by the process relating to the $54,000 loan, Billes knew of her obligations with respect to conflict of interest. Billes testified that (in relation to the Newmat Loan specifically) she "made sure that McAteer knew that I expected he would communicate with his wife". When she was asked how she made sure of this she said "Well I spoke verbally with him". She went on to add that "I instructed someone and, again, I'm not sure who I spoke to directly that I wanted full and ample disclosure in every sense possible legally...". She also stated that the Officer's Certificate that had been used in the Trust Loan to address her concerns had been provided to TM. While Billes, it appears, had discussions with Steinberg about these matters going back to the $54,000 loan, I do not accept the inference in her evidence that she instructed anyone other than McAteer to provide disclosure to Mason and obtain her consent.

[106] Not only did Billes have no reason to conceal her interest in the Lenders or the Loans or their details, she should have known - indeed, her admissions (see emphasized passages above and below) suggest that she did know - that not to do so could put the validly of the Loans, their documentation and security in jeopardy. She had no motivation to do that, and, indeed, her motivation would have been to the contrary.

[107] Third, the relationship between Billes and Mason was not hostile - they met alone for lunch on at least 2 occasions, they spent Christmas together in 1990, and it appears Billes was at her home with McAteer on a number of occasions to pick up or drop off the children, and at least once for "tea". However, even if the relationship was less that a warm one, logic would argue that someone as shrewd as Billes would know that, if there was a problem getting Mason's consent, it was better to deal with it then, rather than later, when the Loans might be at risk. Moreover, remembering that (1) in the original share acquisition by Billes, McAteer obtained $200,000 which was used to pay off an obligation he had to Mason, and (2) $200,000 extra was borrowed in the Newmat Loan to provide a benefit directly to Billes and McAteer, it

was presumably just as easy to increase the amount of either Loan, if monetary consideration was reasonably necessary to obtain Mason's consent, or to buy her out.

[108] Fourth, Billes' testimony that she relied on McAteer's Officer's Certificates as some evidence that he had done what he represented, is corroborative of her testimony that such an undertaking and representations had been made by McAteer. Later in these Reasons, I address in more detail how Billes may rely on these Officer's Certificates.

[109] In the result, I find that McAteer undertook to Billes to make full and proper disclosure of Billes' interests to Mason in a manner that would satisfy the USA and the *ABCA*. Although I do not find any specific request by Billes that disclosure be documented in the minutes, I do find that she left the handling of the matter to McAteer. The performance of this undertaking would have required written disclosure, most likely in an appropriate shareholders' resolution providing Billes' disclosure and refusal to participate in the decision, and Mason's and McAteer's approval to the Loans. The disclosure of this oral information, placed in writing, properly documented and approval of the Loans executed by Mason and McAteer, would have met all the requirements of disclosure to Mason, McAteer and DDL under the USA and at law. I find that is what McAteer undertook to do and represented he had done. In reality, however, he failed to do so.

3. Officer's Certificates

[110] As will be seen in greater detail *infra*, much of the controversy concerns McAteer's certification in paragraph 5 of Officer's Certificates for each Loan (Exhibits 36, 37, 39 and 77) to the effect that DDL was not bound by any provision in any unanimous shareholder agreement which would in any way hinder or restrict the powers of DDL, or the officers of DDL, to authorize, execute and deliver the security for the Loans or which would hinder or restrict DDL from performing its obligations thereunder. These Officer's Certificates, I find, were relied upon by the solicitors preparing the Loans' security in the context of the indoor management rule, the Lenders and Billes in the context of confirming McAteer's representation to her that he had disclosed her interest in writing to Mason and obtained her consent.

[111] McAteer testified in chief that he did not read the Officer's Certificates (and in cross that he did not "believe" he had read them), and that he was unaware of and did not know that an "error" was contained therein before he signed them. I do not accept that evidence as credible for a number of reasons.

[112] First, one starts with the usual presumption that one who signs a formal document is bound by it regardless of whether or not he or she has read it: *L'Estrange v. F. Graucob Ltd.*, [1934] 2 K.B. 394 at 406-407 (C.A.). In *L'Estrange* the Court, per Maugham J., noted two exceptions to this rule, one where the document was signed in circumstances which made it not the act of the signor and the other, where the agreement was induced by fraud or misrepresentation. A third exception was introduced by the Ontario Court of Appeal in *Tilden*

Rent-a-Car v. Glendenning (1978), 83 D.L.R. (3d) 400 (Ont. C.A.) where the Court determined that where the party seeking to enforce the document knew or had reason to know of the other's mistake as to its terms, those terms should not be enforced. The third exception has been given a mixed reception by our Court of Appeal: *Budget-Rent-a-Car of Edmonton Ltd. v. University of Toronto*, [1995] A.J. No. 126 (C.A.), online: QL (AJ); and *American Express Canada Inc. v. International Warranty Co.*, [1994] A.J. No. 101 (C.A.), online: QL (AJ). As none of those exceptions apply in the present case, McAteer is presumed to be bound by the Officer's Certificates.

[113] Second, in the context of credibility, McAteer acknowledged prior to trial that he would not normally sign such certificates without reading them, although he testified to the contrary at trial.

[114] Third, one looks at the knowledge that McAteer, in his particular circumstances, would have regarding the importance of such certificates. McAteer, by his own admission, was an experienced corporate officer and solicitor, who had specialized for some years in real estate development and was (or had been) a member of three provincial Law Societies (Exhibit 10). He testified that he had "signed hundreds, if not thousands, of officers certificates". Even without reading the Officer's Certificates, he acknowledged that he knew that:

> (a) such certificates "frequently, indeed almost inevitably, include a covenant saying that there is ... no impediment to the borrower giving effect to this transaction";
> (b) "the lawyers preparing [the security] and the lenders who were advancing money on [the security] relied, in turn, on the signature of the officer of the company signing this certificate....";
> (c) the "certificates were executed for the purpose of accurately depicting a certain state of affairs of the corporation...."; and
> (d) "the USA had implications to the borrowing", but, in each case he, never told the Lenders' Counsel of its existence.

[115] These Certificates were short, simple, and easy to understand - especially for a solicitor of McAteer's experience. As such, he would, and indeed his testimony demonstrated that he did, understand the importance of ensuring the statements were true. He would also have known that the Lenders and their Counsel would be relying on the Certificates as evidence of compliance with internal procedures.

[116] Fourth, there was internal conflict in his cross as to whether he received the Officer's Certificate for the Trust Loan prior to closing. On one occasion he said he "believed" he did, and on another he denied it, although on discovery he acknowledged that he had. Even if his lack of recall of reviewing a copy of the Certificates for each Loan prior to execution were credible, each Certificate was, in fact, signed at a law office in the presence of Counsel.

[117] Fifth, in his discovery he admitted that he had read the Certificates, and at trial he stated that he “presumably” had read through them, even though on the latter occasion he tried to qualify that answer by saying that he had reviewed the “blacklining” only.
[118] What actually happened? As to the Trust Loan, Whitlock’s evidence, which I accept, and which he specifically confirmed in writing on the date in question (Exhibit 470), was that the Officer’s Certificate was specifically reviewed with McAteer and Lavery on March 13, 1991. As to the Newmat Loan, Marshall used the Officer’s Certificate from the Trust Loan as a precedent because he felt he could rely upon it. Additionally, he testified, and I accept, that he “walked through” the Newmat Loan’s Officer's Certificate with McAteer, told him it was based upon the documentation for the Trust Loan, that he was sure that McAteer reviewed the document and that he signed it in Marshall’s presence.

[119] As such, I find that McAteer read the Officer’s Certificates, and that, when he signed them, he knew specifically what they represented. All of this is significant in itself in this litigation, but it also demonstrates a general lack of credibility on McAteer’s part.

4. Construction Mortgage Loan

[120] It was alleged by McAteer that, in the $1,000,000 construction mortgage loan between DDL and Club LP and Club Ltd., it had been agreed (“the Alleged Agreement”) that the loan would not be enforced until the earliest of either long term financing being secured or September 1993.

[121] I will address the substance regarding the Alleged Agreement placing a limitation on the realization of the construction mortgage loan below. However, the issue is also relevant to credibility.

[122] The credibility issue relates to what I find to be the inconsistency between McAteer’s chief and cross on the issue. In chief, he testified that to the best of his recollection, the Alleged Agreement was the missing Schedule "A" to the Club GP resolution authorizing the construction mortgage (Exhibit 37, Item 19). On cross he was much less definitive, stating alternatively that: (1) he thought it could be but he didn't know; (2) he was not sure; (3) it possibly never existed; and (4) it could have been, or may have been, or he was not certain.

[123] McAteer also made other inconsistent statements about the Alleged Agreement. In chief, he testified that he believed he and Billes signed it prior to March 21, 1991, but in cross he was uncertain whether Billes signed it. On discovery, he had conceded that it was possible that nobody else signed it.

[124] McAteer’s inconsistent evidence indicated a lack of credibility and clearly had an effect on my findings in relation to this issue. This is discussed together with the other evidence in this regard later in these Reasons.

5. Conclusion

[125] Billes referenced other incidents of alleged lack of credibility of McAteer (in testimony or conflicting documents he prepared, signed and/or certified). I need not comment on those, in light of my substantive findings. All of the conflicts and inconsistencies in McAteer's evidence, both as compared to other witnesses and within his own testimony at trial and on discovery, his serious lack of candour on many points, and my finding that many of his assertions were improbable or unbelievable, persuade me that, on crucial points where there is a conflict with his evidence, McAteer's evidence ought to be regarded with great suspicion.

[126] I need not determine McAteer's motivation for his lack of credibility on such important issues. However, I would note the threat he made in a letter to Mason, dated January 25, 1994, following the loss of the foreclosure action in Winnipeg (Exhibit 319) that: "I will continue as a thorn in their side every step they take to force them to the table". In my view this statement also reduces his credibility in these proceedings.

D. Billes v. Marshall

[127] TM in argument[12] acknowledged that there might be a credibility issue between Billes and Marshall on the issue of disclosure of facts which might have raised a need for TM to assess a corporate conflict issue. TM argued, relying upon the support of the evidence of Newel and Lavery, that Marshall's evidence was clear that at no material time was TM ever told that: (1) DDL was subject to the USA; (2) Marlore existed; or (3) Billes/Marlore controlled Newmat.

[128] TM also noted that Billes gave evidence that she relied on McAteer and the lawyers in the context of the conflict of interest, that she "knew [Marshall] knew" about the conflict issue, and that Billes "certainly made sure that [her] shareholdings through Marlore were noted".

[129] I find there is no evidence that Billes directly advised TM of any of the facts that would give rise to a potential conflict issue. To the contrary, while she was aware of the conflict issue, she appears to have left the matter with others to address the issue - as TM argued, she "washed her hands of the deal" . On this issue I am also mindful of the contradictions in Billes' testimony, as set out *supra*. I note specifically that Billes' evidence relating to time, place and substance are contradicted by the documents prepared prior to this litigation, whereas the evidence of Marshall is supported by the documents.

[130] As a result, I find that where the evidence between Marshall and Billes conflict, the evidence of Marshall ought to be accepted.

[12] All references to the written argument of TM exclude the extensive (but helpful) footnote references, unless otherwise noted.

E. Sali & Billes v. McAteer & Mason

[131] Mason and McAteer testified at trial, and McAteer provided evidence by affidavit (Exhibit 118, paragraph 15), that Sali produced an estoppel certificate at the October 9, 1992, meeting between Sali, Billes, Mason, and McAteer. Sali and Billes deny this. Mason described it in her October 12, 1992, letter to McAteer (Exhibit 137) in these terms:

> Sali has unequivocally stated that the basis for any proposal ... would be contingent on my agreeing to waive certain remedies related to apparent irregularities in the assumption and disclosure of third party debt on the part of Billes. (I quote Sali, “if you won’t agree to that, then we have nothing to talk about”).

McAteer supported this in his letter to Desbarats at BJ on October 19, 1992 (Exhibit 139).

[132] I find that no actual estoppel certificate was provided on October 9, 1992 - although one was provided later on November 5, 1992 (Exhibit 143). I find further, however, that what would constitute estoppel was discussed, and that Sali made it clear that there would be no accommodation by the Lenders without an acknowledgment that the Loans and security were validly in place - that is, he demanded an estoppel. The result is the same, only the certificate is missing.

[133] Sali essentially confirmed this conclusion in his letter to Darcy McCaffrey (“McCaffrey”) of TM of October 13, 1992 (Exhibit 138 - which he testified to as being a true and correct representation of the meeting of October 9th), with Billes’ concurrence, where he stated:

> I have seen references in documents created by McAteer to Billes being his “financial partner”, suggestions that the security may not be valid and enforceable, Billes being in conflict with her “fiduciary obligations”...
>
> ... I asked of him a rather basic confirmation, as a condition of extending time, namely that he unequivocally confirm that insofar as he is concerned, the loan agreements and security arrangements would not in any way be challenged by him or under his direction in the event that the time accorded to him did not produce the desired result. He refused, at which time I advised that if that was his position ... we had nothing further to talk about.

Sali made a similar admission in his letter of November 18, 1992, to TM where he stated:

> McAteer will also recall that in our meeting of October 9th past, I told him in fairly straightforward terms that the first matter to be addressed in any such proposal [an asset split] would be to deal with the satisfaction of the creditor claims.

> As for the Officer’s Certificate that was forwarded to you [November 5, 1992 - Exhibit 143], you may recall it was prepared in the context of ensuring that if the extensions being sought by McAteer were granted that there would not be any later contest as to the validity or enforceability of the security documents.

[134] In the result, on the issue of a demand of estoppel, although I accept the evidence of Sali and Billes that there was no actual certificate produced, I accept the substance of evidence of Mason and McAteer over that of Sali and Billes.

F. Lavery

[135] McAteer, in written argument, said this of Lavery: “... Lavery provided evidence in a candid manner. ... Lavery was a believable witness.” I agree, but that does not necessarily mean that his evidence was reliable. I believe that everything Lavery testified to was to the best of his recollection and he was trying to recall accurately. Moreover, on general matters, I generally accept his evidence. However, I find his ability to recollect details, independent of confirming documentation, deplorable. This may well be excusable in light of the passage of time, and I refer again to the words of Virtue J. (*supra*). Nevertheless, in the result, I have found I have had to be very careful with accepting his testimony on such details without independent verification.

G. Newal

[136] McAteer, in written argument, said this of Newal: “...Newal was also a credible witness. He presented his best recollection and did not invoke the “it was so long ago” statement when questioned about any significant event.” I agree.

VI. FACTUAL FINDINGS

[137] In the process of arriving at the within Judgment, in addition to the factual findings buried in the previous sections on credibility, I have made a number of other findings that are relevant to the ultimate conclusions to which I have arrived. Some of these findings may become more clear as these Reasons develop.

[138] The issues relevant to these findings were expressed in the Outline for Argument as “Consequential factual conclusions that flow from the evidence (what follows appear to be some prime factual issues - there may be others).”

A. The Personal Relationship Between McAteer and Billes

[139] The Outline for Argument expressed the issue in this fashion:

> Does anything turn on the personal relationship (or its break-up) of McAteer and Billes (e.g. the allegation in para. 16 of the Statement of Claim in the

> derivative action and in para. 17(a), (b), and (e) of the McAteer/Kingswood Action)? If so, why? If not, why not? What was the result? Are any of the results allegedly attributed to this relationship due to other factors? What are the consequences *vis-à-vis* these actions, in terms of liabilities and remedies?

[140] I find that the personal relationship between Billes and McAteer, and its demise, had very little, if any, legal relevance to any of the issues in this litigation. There were a number of allegations back and forth between the antagonists, wherein they pointed to a number of alleged facts in support. As these Reasons progress there may be more facts found which relate to the relationship, but the following are some summary conclusions and some reasons in support.

1. Termination of Relationship Led to Ignoring DDL and its Shareholders

[141] Mason contended that, following the termination of the McAteer and Billes personal relationship, it was clear that the two no longer wished to do business together and that they ignored the interests of the other shareholders and DDL. I agree that it became increasingly clear as time went on that McAteer and Billes did not want to do business together. Although McAteer wanted Billes to continue providing funds, Billes was increasingly concerned about his management. Regarding Mason's latter allegation, while there was some considerable dedication by McAteer and Billes to DDL's interests until the Golf Dome opened, it waned thereafter and they forgot the other shareholder (Mason) much earlier.

2. Did Billes' Vindictiveness on Breakup Result in Calling of Loans

[142] Mason and McAteer allege that the termination of the personal relationship between Billes and McAteer was an important factor in the eventual demise of DDL. They argue that the evidence demonstrates that Billes wanted to "get even" with McAteer for the breakdown of the relationship and that was what motivated the demand of the Loans at that particular time. I disagree. I find that the Loans were not called as a result of the end of McAteer's personal relationship with Billes.

[143] In response to the allegation in para. 16 of the Statement of Claim in the Derivative Action and in para. 17(a), (b), and (e) of the McAteer Action, I find that it was not the breakup of the personal relationship between Billes and McAteer that prompted Billes to cause, or be involved in, demanding payment on the Trust Loan or the Newmat Loan, placing DDL into receivership, or leading to conditions that put the Kingswood Entities into bankruptcy. Moreover, I find that none of Billes, Lavery, Mann or Newal conspired or acted to further any bitter or vengeful motivation on Billes' part (nor do I find there was any such motivation). Rather, I find that the Lenders made their decisions to advance, call and recover the Loans, based on proper considerations.

[144] Specifically, I find that the reasons for calling the Loans included, but may not be limited to[13]:

> (a) non-payment of the Loans, and the inability to pay these and other loans, after February 1992, without cash, investments, concessions (such as interest reductions - Exhibits 120, 121 and 441 (internal exhibits C and D)), new loans (or advances) by entities connected with Billes[14], or further third party investment. Despite a number of proposals for resolution, there was no solution forthcoming[15], as McAteer explained in testimony in discussion of, *inter alia*, Exhibit 88);
> (b) cost over-runs on the Golf Dome of $400,000 from the original $1,500,000 projected (Exhibit 50);
> (c) McAteer's inattention to management issues, while refusing to remove himself from management (*inter alia*, Exhibit 116, wherein he refused Billes' proposal to take over the operation of the assets), but allegedly seeking double[16] the originally agreed compensation (Exhibits 104, 106 and 109, which stated that they had agreed that April 1, 1992 would be the date for compensation at a market rate, and that his market value was considerably higher, but that his draw (net) would stay at $5.000). As to this, Billes said "it was a surprise to me that McAteer was taking a raise in July of 1992 when DDL had no positive cash flow, in fact it was taking money from DDL and not paying accounts as they became due". Billes stated further that she did not agree with the amount of $10,000, and that the Newmat Loan had provided funds to compensate him on the same basis as before, namely repayment of his shareholders loans;
> (d) non-compliance with loan covenants, including further advances obtained or sought from the TD and Royal Bank (*inter alia*: Exhibit 37, Tab 22; Exhibit 114; and Exhibit 187);
> (e) McAteer appropriated money for himself personally from the TM trust account (Exhibit 186, p. 25);
> (f) dismissal of the Chief Financial Officer, George Harms ("Harms"), whom Billes and Newel trusted to provide honest accounting and information;

[13] Also see Exhibit 100 of June 1992, where McAteer himself analysized historically "Where did we fall down? However, in the same month (Exhibit 101) he concluded "all appears well", in spite of numerous problems which he discussed.

[14] See, among other references, Exhibits: 85a - 89; 99; 110; 111; 120; 121; 321. Albikin injected approximately $250,000 during the period under the Stand Still Agreement to cover immediate payables.

[15] See, among other references, Exhibits: 107; 119; 119A; 122; 125; 128; 129; 131; 136; 141; 145; and 150.

[16] McAteer explained this in chief as a gross amount of $10,000, to generate a net $5,000 after tax, consistent with the agreement he said he had with Billes. Ultimately it was settled at $7,500 gross.

(g) inability to sell lots and thereby generate cash flow (see Exhibit 101), and lack of any other apparent sources of cash:

(i) attempts to obtain financing from the CIBC in October 1990 (Exhibit 24) were declined;

(ii) an introduction to the Royal Bank in late 1990 (*inter alia*, Exhibit 26) did not garner any interest or the proposals were unacceptable. In one instance, while Billes was prepared in principle to provide a guarantee as requested (Exhibits 48 and 50) and her ability to cover the amount in question was provided (Exhibit 49), she did not approve of the proposal. In another case, the amounts were too small and she was not prepared to give a guarantee (Exhibit 54);

(iii) discussions later in 1991 with the Bank of Montreal (Exhibits 50 (card on first page) and 51), Canada Trust and the Maple Leaf Fund (Exhibit 18) did not work out;

(iv) a commitment letter by Household Finance later in 1991 (Exhibits 53, 54 and 307) was not acceptable as it provided for insufficient funds and required a guarantee that Billes was not prepared to give;

(v) the proposed limited partnership with the Security Trading Group for the purpose of obtaining syndication-type financing (Exhibits 95 & 142a) did not proceed; and

(vi) the relationship between McAteer and Billes had deteriorated such that possible interest by Husky Oil, Lux Construction Inc., Markum Golf and Fox Hollow Golf Dome did not materialize, and there were no attempts at financing after November 27, 1992;

(h) the Trust and Newmat Loans were not only in arrears, but their validity was being challenged by Mason and McAteer;

(i) the need for funding to meet other cash flow problems, which in May 1992 reached a gross of in excess of $170,000 (Exhibit 321). In response, $60,000 was advanced by Albikin in June 1992 (Exhibit 99 - memorandum of agreement but no other loan or security documentation) and another $550,000 was requested in July 1992 (Exhibit 111);

(j) continuing deficit in income in HAL (Exhibit 102); and

(k) a genuine lack of faith, trust, and confidence by Billes, the Lenders, and their principals, in any improvement in the financial and operating conditions of DDL and the Kingswood Entities, under McAteer's management. This was seen in the Sill Report (Exhibit 186) and the evidence of Ian Best ("Best") and Jay Mustapha ("Mustapha"). This is supported by the fact that McAteer proposed no new and/or realistically effective solutions to solve the problems being faced, and no proposals in Bankruptcy were made by McAteer regarding the Kingswood Entities. In this regard, BJ argued, that McAteer's "dream for the success of the DDL/Kingswood entities far exceeded his ability to manage the entities through periods of business adversity". I agree. Also, both Billes and Lavery wanted McAteer out of DDL (Exhibit 107 and the evidence of both) and McAteer refused to leave (Exhibit 109). Evidence that supported this lack of

> confidence included the practice, testified to by Harms, of the directions by McAteer to shuffle money among related entities. Additionally, McAteer was not actively present much of the time, projections were often inflated to look optimistic, accounting records were incomplete and the ability to service the debt was never clearly in hand.

[145] In elaboration and support of these reasons for calling the Loans, Lavery testified that in July 1992 he had concerns about:

> (a) interest payments not being made;
> (b) lot sales declining sharply;
> (c) the lack of time that McAteer was spending on DDL/Kingswood projects - including diverting his attention to new Golf Dome projects rather than concentration on the profitability of the projects they had in place;
> (d) the increase of the Royal Bank line of credit without the approval of the Trust in accordance with its security documentation;
> (e) cash flow being a significant problem for DDL (McAteer acknowledged that this was a constant battle for a development company - that was the nature of the business);
> (f) HAL was having problems with staff supervision, damaged suites and an inability to rent them and was experiencing financial difficulties in not being able to service its mortgage; and
> (g) there was clearly a loss of confidence between the partners, McAteer and Billes (Exhibits 123, 123e, 123i).

[146] In argument Billes emphasized these points and others from Lavery's testimony and concluded the point by noting that:

> As a trustee, [Lavery] was in agreement to demand the Trust loan. His reasons are set out at pp. 1397 - 1399[17]. He reviewed the Sill Report. His conclusions are at pp. 1399 - 1400. By May 1993[18], he had personally lost confidence in McAteer's devotion to the day-to-day management (see 1400 - 1402).

[147] Billes argued[18] that the Sill Report (Exhibit 186) caused her to conclude that:

> (a) the management was not effective;
> (b) there were no accounting controls in place that could be relied upon;
> (c) records and accounting were not up to date;

[17] Referencing the trial transcript.

[18] *Sic* - I believe he may have meant May 1992, because by May 1993 the security was under receivership, and litigation had commenced.

(d) McAteer should have been relinquishing his position in the companies; and
(e) $800,000 to $1 million, she was “appalled to learn”, would be required to meet current liabilities and payables, excluding any principal payments on long-term debt.

Based on those conclusions Billes was willing to consider a proposal, within certain parameters: payout the secured creditors or, if they were to proceed, management was not to include McAteer.

[148] The evidence of Best and Mustapha was supportive of these conclusions, while referencing still other or related concerns, including:

(a) lack of financial and management controls;
(b) there were many errors in the accounting records;
(c) proper personnel management procedures were not in place; McAteer was often absent from giving instructions or direction;
(d) there was little activity in lot sales, but McAteer rejected marketing plan initiatives to stimulate sales;
(e) when there were lot sales there was noncompliance of net sales payments to the Royal Bank;
(e) HAL was a non-performing asset that was in very poor condition and was continuing to deteriorate;
(f) tax returns were not current; and
(g) the debt/equity ratio of all the entities combined was 56:1; i.e., $56 in debt for every $1 of equity.

[149] Neither Lender was prepared to convert its debt into equity, which is understandable in the circumstances, especially with almost $1,000,000 in payables outstanding. The Lenders could not reasonably be expected to extend more time or provide more funds in all the circumstances.
[150] Generally, I agree with the above submissions.

[151] Billes argued further that, after August, 1992, there were no reasonable steps that she could have taken as a director of DDL, as DDL and the Kingswood entities were hopelessly insolvent. On that basis she argued that her obligations as a director were to act primarily with due regard to the interests of the creditors. As authority for that proposition she relied on: *Kinsela and another v. Russell Kinsela Property Ltd.* (In. Liq.) (1986), 4 N.S.W.L.R. 722 (C.A.); *Walker v. Wimborne* (1976), 137 C.L.R. 1 (Aus. H.C.); *Nicholson v. Permakraft* (N.Z.) Ltd., [1985] 1 N.Z.L.R. 242 (C.A.); *The Clarkson Co. Ltd. v. Shaheen* 660 F. 2d 506 (1981, Cir. 2); *West Mercia Safetywear Ltd. v. Dodd*, [1988] B.C.L.C. 250 (Eng. C.A.); *Colborne* (Q.B.). On the facts of this case, I am not satisfied that, in effect, abandoning DDL in favour of the creditors was her primary obligation. Moreover, this is not a principle that seems to be well developed in Canada. However, the whole discussion, considering that she was personally a

creditor (the Trust) and a director of another creditor (Newmat), reconfirms her conflict in this case.

3. Role of Golf Dome Construction

[152] Mason argued under this heading that “the reason DDL [was] in financial difficulty [was] as a result of McAteer's and Billes' decision to proceed with the Golf Dome construction which had the effect of consuming financial resources and taking attention away from the real estate and golf course development”. I believe this deserves a comment. I find that this is substantially true in the result, notwithstanding sound intent. However, it is not causally related to the breakdown of McAteer and Billes’ personal relationship.

[153] Factually, I find that the intent of the Golf Dome was sincere. It provided a facility within Winnipeg to keep golf alive during the winter months when the golf course was closed and dormant. During the winter season, it utilized existing personnel to continue the marketing of golf products, while promoting the Kingswood golf course and development. This appears to have been McAteer’s idea based on Golf Dome projects in other cities. It appears that he convinced Billes that it was a good idea and she obtained the Newmat Loan to support it. However, the cost of the facility, as compared to immediate benefits (that is, net cash flow), and the preoccupation of McAteer with the development of other domes, at the expense of attention to the development of the golf course and its residential lots, put a double strain on the available financial resources. DDL and the Kingswood Entities were unable to recover from those strains, without the further injection of funds to cover the short term, which were not forthcoming. I refer to the short term because, while Best (Exhibit 186, p. 57) found that profits were at the break even level or below in 1992, he also found that there was “potential for significant future profit and cash flow inherent in the operations of the Golf Dome and the Kingswood golf club....”.

[154] In any event, to the extent that it is a criticism of management decision making, it is not actionable: see discussion under the Derivative Action, *infra*.

4. Impasse, not Vindictiveness, Doomed DDL

[155] The problem at DDL was not only financial. There was also the problem of having someone with the ability and willingness to effectively manage the project to achieve this. Billes was not confident that McAteer was willing or able to do so. He appeared to be wishing to spend more and more money on developing golf domes in other centres than concentrating on making these existing projects successful. However, despite all of Billes’ concerns after March 1992, I find it interesting to note that in Exhibit 89, Billes also promotes further investment in a Toronto dome and ends by stating: “We have an excellent team and a fine record in Winnipeg. We can all be very proud of the DDL/Kingswood success!” Nevertheless, Billes asked McAteer to leave management and he refused. Billes’ testimony indicated that she and the Lenders felt, quite correctly in my view, that they could not legally move McAteer out under the existing corporate structure. It appeared to be the view of Sill that, had McAteer and

Billes been able to come to a mutual agreement regarding competent third party management, the project may well have continued on to ultimate success.

[156] While the Court is not a business failure pathologist, this last comment points to yet another reason, in addition to the host of others set out *supra*, for the ultimate collapse of DDL. Mason argued that Billes was a scorned woman “with the intention to ‘get even’ with McAteer”. She argued further that “[t]he perfect plan of revenge would be to take the Kingswood projects away from McAteer. Ultimately, as a result of the disposition of the assets, Billes achieved that goal, while retaining ownership of all of the assets except the Kingswood real estate.” McAteer supported Mason’s arguments, and argued further that Billes’ conduct was “vindictive” in her “squeeze play” to remove McAteer from management, and that she “is a person who must have control”. I do not accept these arguments, notwithstanding that there is some evidence (e.g. Exhibits 309 and 107) which may tend to indicate that this was the case. Although DDL was very weakened by the factors identified above that caused the Lenders to proceed to realize on their security, I find, based largely on the evidence of Sill, that it was not revenge, but rather an impasse between two head strong individuals that caused the ultimate downfall of DDL. In the end, Billes and McAteer were not prepared to put the interests of all the shareholders of DDL ahead of their personal stubbornness for “control”and that ultimately doomed DDL and the Kingswood Entities.

[157] The evidence in support of this conclusion is succinctly stated in the Sill Business Report issued during the Stand Still Agreement (Exhibit 186, at 57), where Best writes:

> Unless the shareholder dispute is satisfactorily resolved soon, the continued normal operation of the Related Entities, for an extended period of time, is doubtful. ... Failure to resolve the dispute could result in prolonged litigation and possible actions initiated by secured and unsecured creditors, as well as other parties, resulting in further disruptions. ... Taken to the *extreme*, continued disruptions could result in the distress disposal of some or all of the companies' property and assets which would likely result in significant financial losses to creditors, investors, and shareholders. [Emphasis added.]

The “extreme” manifested itself, as he warned.

[158] While I agree with Mason that the “break-up of the relationship between Billes and McAteer is at the heart of this dispute”, it is only in the sense that it led to the impasse and not because it led to a unilateral act of revenge by Billes. Both McAteer and Billes are responsible for the impasse. The innocent party in the whole mess was Mason, who was the only shareholder without knowledge of Billes’ conflict and whose shareholders interests were ignored.

5. Loans in the Best Interests of DDL

[159] While this will be addressed in more detail, *infra*, rather than the Loans being part of some self-motivated Machiavellian plan by Billes to acquire control of DDL and the Kingswood Entities, I find that the Loans were made because they (except for the $200,000 Loan) were believed by both McAteer and Billes to be in the legitimate best interests of DDL. Specifically, except for the $200,000 Loan, it is clear to me that McAteer believed the Loans were in the best interests of DDL, or he would not have proposed and followed through with, such financing. Indeed, he was specifically asked at trial in the context of the Trust Loan and agreed that the Loan was in DDL's best interests. The same conclusion follows for the Newmat Loan. Moreover, the evidence demonstrates that McAteer was unable to secure any other suitable financing.

6. Personal Relationship not Relevant to Third Parties

[160] BJ observed that "any wrongful act (to use a legally neutral phrase) arising out of the personal relationship cannot trigger any indemnity claim against these Third Parties". Without a full explanation of what is meant by "wrongful act" this is difficult to determine. However, without trying to consider numerous possible hypotheticals, on the facts of this case and the issues as alleged, I agree. Moreover, the Third Parties, BJ and TM, had no role in the breakdown of the relationship, although I find that the adversarial aggressiveness of Sali did anything but try to find a meaningful compromise.

B. Provision of Legal Services by McAteer

[161] The Outline for Argument on this topic asked:

> Did McAteer provide legal services to Billes (or related entities)? If so, in what capacity and did any duties arise as a result in terms of other matters? What evidence supports that conclusion? What relevance does such advice have to any decisions the Court has to make in these proceedings?

[162] I find that McAteer provided no legal services to Billes or to the Lenders in relation to the Loans, but did provide corporate secretary/corporate governance services to DDL, including those relevant to the Loans. I will elaborate.

[163] Billes submitted that McAteer purported to provide legal services to her, to DDL and to Kingswood relating to the Loans. In that regard, Billes submitted that she relied on McAteer, as a lawyer, to ensure that all legal requirements with respect to the Loans were met. I find this to be untrue. In particular, Billes stated that she asked McAteer to ensure that the other shareholder, Mason, was in agreement and that he reported that he had done so. I find this to be true, but not in any role as legal counsel.

[164] I find, on the evidence, that McAteer, although then a lawyer and member of the Law Societies of Alberta, Manitoba and British Columbia (not practising in the latter two - Exhibit 22), did not purport to act as Billes' legal counsel in relation to the Loans. *Vis-à-vis* DDL,

McAteer's role was as a shareholder, officer and director of DDL. Moreover, *vis-à-vis* Counsel for the Lenders, with his legal training and experience, in his capacity as an officer of DDL, he did perform some corporate secretarial functions. His business relationship with Billes was as a fellow shareholder, director and officer of DDL and a special relationship that grew from that - their personal relationship. However, in his undertaking to Billes that he would advise Mason of Billes' interests in the Lenders and obtain Mason's consent, and his representation that he had done so, I find he was only acting in his personal capacity, having regard to his personal relationship to Mason and Billes. As to legal advice for the Loans, independent Counsel were retained on both the Trust Loan (BJ) and the Newmat Loan (TM).

[165] Billes testified that McAteer provided legal services to the Lands End project. DDL did have a contract to provide management, marketing and development services to the latter in consideration of a participating interest (Exhibit 308). However, there was no reference to the provision of legal services except that McAteer was to hire such services. In Exhibit 40, McAteer billed $10,000 for "services"(paid by Exhibit 44), but there is no reference in either to "legal" fees, or "legal" services or him performing the "services" as a lawyer. Even if he did provide legal services, which I do not find, that is not relevant to anything I have to decide herein, especially since the Billes company involved in the Lands End project (328690 British Columbia Limited) is not a party to these actions. However, and more importantly, there is no evidence that McAteer provided legal services or billed therefor, to any other Billes related entities involved in the Loans. Nor is there any evidence that McAteer provided any such services to Billes directly relative to any matter in dispute in these actions. Billes' evidence was that she was relying on Whitlock in the Trust Loan and Marshall in the Newmat Loan. She also received advice periodically from other counsel including, Michael Robison at McCarthy Tetrault, Steinberg, Rita Guthrie at McKimmie Mathews and possibly others.

[166] Kingswood Development paid McAteer $10,000 on April 23, 1991 for what the cheque said, in McAteer's writing, was "Legal fees 1990/91" (Exhibit 43). When challenged on it in cross, he claimed that it was a cheque to pay his taxes, explaining that "[b]ecause of the accounting coding in the Kingswood accounting records, they have to be accounted for as legal fees". He denied he ever provided legal services to either DDL or Billes, and that legal advice was always provided by outside counsel. While this accounting procedure has a suspicious appearance, I am satisfied that it was a way of getting money out of Kingswood for personal purposes (personal taxes), rather than payment for legal services. In any event, this is not determinative of anything I have to decide, even if it were for legal services, because there is no evidence of any link to Billes.

[167] McAteer did admit that he provided "counsel to DDL and the Kingswood entities from time to time". However, I understood that to mean general advice, not legal advice. Such would be expected from a director and officer, and in those roles one would not expect him to ignore his legal knowledge and experience. That is different than acting as counsel. On the evidence, it appeared that, aside from advice *qua* director, officer and shareholder, any services that McAteer provided were in the nature of a corporate secretary to, or for the corporate governance of, DDL and the Kingswood entities.

[168] As noted here and elsewhere in these Reasons, I accept Billes' evidence that she relied on McAteer with respect to disclosing in writing her interests in the Lenders to Mason, and in obtaining Mason's shareholder's consent to the Loans. I also accept that he had reported to her that he had done so. However, I do not find that she relied on McAteer as legal counsel.

[169] BJ argued:

> McAteer was counsel to DDL in respect to the Trust Loan (Whitlock's testimony), and these Third Parties were entitled to rely on the factual statements and Officer's Certificate of McAteer to the same effect as though it were a solicitor's opinion from the borrower. McAteer's background and role are relevant to the reasonableness of Whitlock's reliance. No evidence was adduced to question Whitlock's judgment in relying on McAteer in the totality of the circumstances.

I agree with BJ's (and TM's) entitlement to rely upon the Officer's Certificate(s), but I find it does so with McAteer in the capacity of an officer, not as counsel, although, again, his legal background and experience rightly gave an even greater confidence in reliance on his certification.

C. Interim Collateral Agreement Pending Long Term Financing - The "Alleged Agreement"

[170] In the Outline for Argument, the issue was expressed thus:

> Was there an agreement collateral to the Trust Loan and/or the Newmat Loan whereby the parties agreed that there would not be a demand or payment of interest or principal until permanent long term financing had been secured, or until the occurrence of some other event? If so, what were the terms and what evidence supports/detracts from such a claim?

[171] Mason submitted that there was evidence of a collateral agreement (the Alleged Agreement) between Club LP and Club Ltd. on the one hand and DDL or Devoncroft (Winnipeg) Ltd.[19] ("Devoncroft (Winnipeg)", or "DDL (Winnipeg)", or "DDLW") on the other hand, to the effect that DDL and/or DDLW would not call the $1,000,000.00 mortgage owed by Club LP and Club Ltd. until permanent long term financing had been secured or until September 1993[20]. Mason argued that evidence of this Alleged Agreement was contained in

[19] A Manitoba corporation, for which (while there is some conflicting evidence) McAteer, at all material times, was sole officer and director.

[20] Note from Exhibit 37, Tab 10, that September 3, 1993 was the date for the principle payment under the mortgage.

the financial statements, particularly, Note 4 (Exhibits 46(a) and 93). McAteer testified that this understanding was also reduced to writing and signed by the Curtises, Ben Smirnov ("Smirnov") and himself, however, this document was not produced in evidence.

[172] The DDLW mortgage was assigned to DDL and further assigned by DDL to the Trust as part of the Trust Loan security (Exhibit 37, Tabs 6 and 7). The effect of this argument, as I understand it, is that, if found to be factual, the Trust would be bound by this restriction on the security it accepted, and as a result could not have legally proceeded to realize on the Kingswood security (including the Manitoba foreclosure) until the contingent term had been met.

[173] Billes and Lavery denied the existence of the Alleged Agreement. In the alternative, Billes argued that the Lenders or Billes were never privy to any such Alleged Agreement, and accordingly it could not affect the Lenders. In the further alternative, Billes argued that McAteer and Mason were estopped from alleging or relying upon such an agreement in opposition to the enforceability of the Loans, as a result of the Manitoba foreclosure proceeding. In that regard Billes relied on *Argentia Beach (Summer Village) v. Warshawski* (1990), 105 A.R. 35 (C.A.); *420093 B.C. Ltd. v. Bank of Montreal* (1995), 174 A.R. 214 (C.A.); *Roenisch v. Roenisch* (1991), 123 A.R. 303 (Q.B.), 115 A.R. 255 (C.A.); *Morguard Investments Ltd. v. De Savoye*, [1990] 3, S.C.R. 1077; *Malik v. Principal Savings & Trust Co.* (1985), 63 A.R. 109 (Q.B.); *Royal Bank v. LRSCO Investments Ltd.* (1994), 18 Alta. L.R. (3d) 148 (C.A.) refused leave to appeal (1994), Alta. L.R. (3d) xxxix (S.C.C.); G.S. Bower, A.K. Turner and K.R. Handley, *The Doctrine of Res Adjudicata*, 3rd ed. by K.R. Handley (London: Butterworths,1996); *Solomon v. Smith*, [1988] 1 W.W.R. 410 (Man. C.A.); *Wavel Ventures Corp. v. Constantini* (1996), 193 A.R. 81 (C.A.), [1999] S.C.C.A. No. 279; and *Bjarnarsen v. Manitoba*, [1988] 1 W.W.R. 422 (Man. C.A.). As a result of my findings which follow, I do not need to consider these alternative arguments.

[174] McAteer testified in chief as to why such an Alleged Agreement had been made and reduced to writing. His evidence was that the Alleged Agreement formed the missing Schedule "A" to the Club GP resolution authorizing the construction mortgage (Exhibit 37, Item 19). There is reference to it in Note 4 to the financial statements of Club LP as at April 30, 1991 (Exhibits 46a, 90c, 91 and 93), prepared by Deloittes. McAteer says the Note was prepared by him and Lavery. The Note is then repeated in the 1992 statements by Mustapha. The Note states "The construction mortgage [of $425,000] payable to [DDL] ... is secured by the golf course and is due on demand. [DDL] has agreed that payment will not be demanded until long-term financing is secured". McAteer further testified that he was unable to find a copy of the Alleged Agreement after the receivership but that copies were kept by DDL at Wolfe Street (Billes' residence) in Calgary, one by Larry Braun (accountant at Deloittes reporting to Lavery) ("Braun") and one in the DDL files in the Golf Dome at the time of receivership (which documents he testified he lost access to on the receivership).

[175] The mortgage shown at $425,000 in the 1991 financial statements (Exhibit 46c) was increased to $1,000,000 by the mortgage between Club Ltd. to DDL Winnipeg, dated February 22, 1991 (Exhibit 32) and shown in the 1992 financial statements (Exhibits 90c, 91 and 93).

The latter funds were obtained from the Trust Loan. The mortgage was assigned by DDLW to DDL to the Trust.

[176] As to the Alleged Agreement:

(a) it was not produced in evidence;
(b) it is not referenced in any pleading;
(c) all the evidence was to the effect that no one (including Billes, Lavery, Richard Hester ("Hester"), Braun, Harms, Mustapha, Best, Newel and Owen Billes), other than possibly McAteer, had seen such a document or reference to it on any of their files (the Curtises and Smirnov were not called to testify);
(d) McAteer very much equivocated on his previous chief when he was crossed on it, acknowledging that he was not sure if it was the missing Schedule "A" (see discussion under credibility *supra*);
(e) Lavery denied being the author of the Note to the financial statements;
(f) Lavery's associates in Winnipeg and Calgary, Hester (engagement partner for the Kingswood entities) testified that Note 4 was inserted based on information from McAteer, or Harms;
(g) Harms testified that he did not provide any advice to anyone at Deloittes with respect to the final sentence of Note 4, nor hear or participate in any discussion as to the existence of such an agreement;
(h) Mustapha testified that: McAteer gave him a copy of the prior year's financial statements prepared by Deloittes; he reviewed the Notes; he had discussions about the Alleged Agreement on two occasions with the limited partners, the Curtises, in the presence of McAteer; he could not confirm or deny the Alleged Agreement; and McAteer represented the existence of the Note and, thus, it was included; and
(i) Best was not advised by any party about the Alleged Agreement, nor did he remove any documents from the Golf Dome or books and records relative thereto.

[177] More detailed evidence and argument denying the existence of the Alleged Agreement rests on the Court record. Moreover, the Manitoba Court of Queen's Bench, in denying McAteer a rehearing (requested February 18, 1994 - Exhibit 249) to stay the foreclosure of the front 9 by the Trust, noted in the rejection letter of March 2, 1994 (Exhibit 253) that "If there was an agreement that no action would be taken on the security there is nothing in the material filed to suggest this".

[178] I find, on the skimpy evidence in support, and the overwhelming evidence to the contrary, that the Alleged Agreement restricting the enforcement of the Trust Loan to September 1993 never existed. The only evidence of any such agreement was from McAteer. That evidence is not supported by any document or corroborative testimony at trial, and, indeed, is contradicted by the construction loan documentation itself (see the other Schedules to the Club GP Resolution in Exhibit 37, Item 19, such as the promissory note and the terms of the appended unsigned construction mortgage, particularly para. 13 thereof.) Moreover, it is inconsistent with the proposed amendments sought in August 1992 (Exhibit 121). For these

reasons, in combination with my findings regarding McAteer's credibility generally, I find McAteer's evidence in this regard to be less than compelling.

[179] Further, even if such an Alleged Agreement existed, it would be insufficient to bind Newmat or the Trust, without it being referenced in documentation that was brought to their attention prior to the Loans, or specifically agreed to by them. There is no evidence that any such steps were taken.

[180] The result of finding no such Alleged Agreement is that the Lenders were not precluded for this reason from proceeding to realize on their security as they did.

D. Billes' Interest in the Lenders, McAteer's Knowledge Thereof and Their Roles in Approving the Loans

[181] The issue in question here was framed in the Outline for Argument as such:

> Is there some interest of Billes' of relevance to the Trust Loan or Newmat Loan that is now known and on the record, which McAteer was not aware of prior to the execution of those loans? If so, what was it and what effect does it have?

I have concluded that the answer to the first question is "No". Thus, I need not answer the second question.

[182] While this section was limited to McAteer's knowledge of Billes' interests, I have found that not only did he have knowledge, but he assumed a role in disclosing that interest to Mason and obtaining her consent. I find further, that he then assured Billes that he had done so. Therefore, I will expand this section to provide some of the factual basis for these conclusions.

[183] Specifically, having considered the evidence, I find that:

> (a) Billes did make full oral disclosure to McAteer of her financial circumstances prior to the respective Trust and Newmat loans. Specifically;
>
> > (i) McAteer knew that Billes had *de facto* control of the Trust (in fact Lavery testified that he told him as much); and
> >
> > (ii) McAteer knew, prior to the Newmat Loan closing, that Billes, through Marlore, had a 49% interest in Newmat and was a director. Indeed, McAteer also thought she was an officer, as he admitted on cross, although that was not the case;
>
> (b) McAteer undertook to Billes to notify Mason in writing as to Billes' interest and to obtain the necessary written consents from Mason to the respective Trust and Newmat Loans and to otherwise ensure that the disclosure met the requirements of the USA and *ABCA*. Billes relied upon McAteer to fulfill that undertaking and, although he failed to do so, he represented to her that he had; and

> (c) McAteer did read and was aware of the contents of the Officer's Certificates (Exhibits 36, 37, 39 and 77) before he signed those documents, and knew that they were false. Nevertheless, he allowed them to be relied upon by BJ, TM, the Lenders and Billes.

The following section will expand on these conclusions.

1. McAteer's Knowledge

[184] McAteer argues that any disclosure Billes provided to him regarding her interest in the Trust and Newmat was insufficient and misleading. Thus, he argues that he was unable to determine if Billes was in a conflict position and/or that he could not provide Mason with full and fair disclosure. McAteer also suggests that the rule *suppressio veri* applies such that if the alleged suppression of the truth, in this case Billes' control of the Trust, can be proven, then the Loans must be set aside.

[185] To determine what McAteer's knowledge of Billes' interests was, it is first necessary to understand what those interests actually were. That is easy for Newmat, but not so easy for the Trust.

a. The Trust

i. Billes' Actual Interest

[186] McAteer in argument acknowledged that:

> Billes made disclosure to McAteer that she was one of three trustees for the Trust, but added that she did not control the Trust. Lavery confirmed this information to McAteer. ... Because Billes added the qualifier "did not control" the Trust any disclosure was not sufficient as she, at the very least, mislead McAteer and minimized her interest and control of the Trust. (*Suppressio veri*)[21]

[187] As a trust is not a legal entity, Billes, as a Trustee of the Trust, was in effect one of three "principals" constituting the Trust. In addition, I find that Billes did not have legal control, but rather enjoyed *de facto* control, or was the "directing mind" or the "controlling mind", of the Trust. I come to this conclusion for several reasons, notwithstanding that Billes

[21] Meaning "misrepresentation" - literally "suppression of the truth".

took no personal benefit from the Trust, either through the terms of the Will setting it up, or by way of compensation for her duties as a Trustee (nor did the other Trustees).

[188] First, it was a trust set up by Billes' mother's Will, for Billes' son, Owen (Exhibit 1).

[189] Second, when Billes' mother died on August 13, 1979 (Exhibit 6), the original Trustees were Billes and her two brothers. However, on December 31, 1989, on the resignation of her two brothers, Billes, as the remaining Trustee, appointed Lavery and Mann as replacement Trustees (Exhibit 11). Lavery, was otherwise retained by her as her accountant and financial advisor. Mann, was a Canadian Tire dealer in Toronto, whom Billes met with frequently on other matters. While the extent of Billes' interest in Canadian Tire was not introduced into evidence, it is not disputed that Billes had a significant, perhaps controlling interest in that corporation. Accordingly, she was in a position of some business "authority" to each of the other Trustees. Moreover, it is clear to me from the testimony of Mann that, although he talked occasionally with Lavery by telephone (alone or with Billes), his main contact with the Trust was Billes. Additionally, Mann, while maintaining that Billes never gave him any directions, acknowledged that he never made a decision that was contrary to Billes' wishes regarding the Trust.

[190] Third, Lavery testified that he told McAteer that Billes "was in effect the central mind and management", and the "controlling mind" of the Trust. Moreover, albeit after the placement of the Trust Loan, Lavery also confirmed that he understood that Billes had made a decision to defer the collection of interest on the Trust Loan during the summer of 1992, without consulting him as a Trustee.

[191] From this evidence, I find that Billes was the *de facto* "chair" of the three Trustees and that she also had *de facto* control of the Trust.

[192] There is legal support for the relevance of *de facto* control. In the opinion letter of Coopers & Lybrand (Exhibit 247), introduced for another purpose, the author noted that:

> The courts have also held that in certain cases, excessive and/or constant advantage, authority or influence can constitute *de facto* control which may result in bringing both parties into a non-arm's length relationship.

The wording used by the author in this tax opinion closely resembles the wording used by the Canada Customs and Revenue Agency in paragraph 18 of Interpretation Bulletin IT-419R:

> The courts have also held, in certain cases, that excessive or constant advantage, authority or influence can constitute *de facto* control (i.e., effective without legal control). This situation can bring parties into a non-arm's length relationship....

IT-419R has been referred to by the Tax Court of Canada, when addressing the question of whether a transaction was completed at arm's length, on a number of occasions, including: *Craig Brothers Ltd.* v. *Canada (Minister of National Revenue - M.N.R.),* [1996] T.C.J. No. 226, online:

QL (TCJ); *Freedman Holdings Inc. v. Her Majesty the Queen* (1996), 96 D.T.C. 1447 (T.C.C.), online: QL (TCJ) [1996] T.C.J. No. 514; and *Normand* v. *Canada (Minister of National Revenue - M.N.R.)*, [2000] T.C.J. No. 351, (T.C.C.), online: QL (TCJ). In *Robson Leather Co.* v. *Canada (Minister of National Revenue - M.N.R.)* (1977), 77 D.T.C. 5106 (Fed. C.A.) the Federal Court of Appeal determined that a shareholder who could exert pressure, to have his will prevail in the running of a business, had *de facto* control.

[193] The existence of *de facto* control has also been considered in situations outside of the realm of income tax. For example, in *Re. A. Zimet Ltd. et al.; J. Friedman Receivers and Trustee et al. (Trustee in Bankruptcy)* v. *Woodbine Summit Ltd.* (1985), 31 B.L.R. 277 at 302 (Ont. S.C.H.C.J.), aff'd (1987), 64 C.B.R. (NS) 89 (Ont. C.A.), Sutherland, J. stated:

> *De facto* control is not necessarily dependent upon share ownership or upon powers derived from share ownership. It can arise as a result of family or personal influence of a benign sort or, on the other hand, from fear of reprisals, or from extortion or blackmail, among other causes ... *De facto* control could arise from many things, including extraneous factors and is in that sense an open-ended concept.

[194] I find that Lavery and Mann were technically independent Trustees. However, having regard to: the source of the trust (Billes' mother); the beneficiary of the trust (Billes' son); the relationship of both of the Trustees to Billes; their appointment and the manner in which the Trust operated; I find that their independence was limited. While Lavery or Mann would have made suggestions and given advice with regard to the Trust, I believe on all reasonable "commercial" transactions, such as I find the Trust Loan to have been, neither would have disagreed with any of Billes' decisions regarding the Trust that were not illegal. Mann, the barest trustee among the three, made this quite clear in his testimony.

ii. McAteer's Knowledge

[195] I have discussed McAteer's knowledge of Billes' interest in the Lenders in the context of credibility *supra*, noting his acknowledgment in the December 23, 1990 Domestic Contract between them (Exhibit 21), Billes' evidence regarding that disclosure and the documentation made available to him in conjunction therewith.

[196] I find that, prior to the Trust Loan, McAteer was not only aware that Billes was a Trustee to the Trust, but, that she exercised *de facto* control of the Trust.

b. Newmat

i. Billes' Actual Interest

[197] Billes owned a 49% interest in Newmat, through Marlore, and was also a director.

ii. McAteer's Knowledge

[198] I find that, prior to the Newmat Loan, McAteer was aware of the precise nature of this interest, although he was also of the erroneous belief that Billes was also an officer. He stated that he understood the interest to be in the nature of a "carve out", such that Billes' income from Newmat would be sheltered against losses carried forward. However, whatever the characterization of the interest and Billes' intent, I find that McAteer was aware of Billes' true interest in Newmat.

[199] As to his specific knowledge of Billes' interest in Newmat, my findings are based on his evidence at trial, in particular his cross by Billes and TM. This includes his acknowledgement that a memorandum setting out her share interest was in his hand writing (Exhibit 316). His evidence was that he wrote it "just before the loan [from] Newmat - early October [1991]". I accept this evidence, noting that it contradicts a statement in his affidavit of December 2, 1992 (Exhibit 318 - specifically paragraph 11), which stated:

> I do not recall ever being advised prior to or at the time of the Newmat Financing, in any fashion whatsoever, that Billes had an interest in Newmat. All that she disclosed was that she had a tax related arrangement which flowed income through Newmat to utilize tax losses. I have subsequently learned through corporate searches that Billes has a 49% shareholding interest (through a company called Marlore Enterprises Ltd. wholly owned by her) in Newmat.

I find this sworn statement, which was intended to be relied upon by the Court, to be false regarding his knowledge at the time of the Newmat Loan.

[200] McAteer also admitted, in cross by TM, his specific knowledge of the details of Billes' interest prior to the execution of the Newmat Loan, "but the 49 percent was a result of a tax flow-through arrangement". I also come to this conclusion of his knowledge, notwithstanding McAteer's attempt to limit the interest to a "carve out" or "tax flow-through arrangement". In that regard, I do not challenge his recollection of the conversation between him and Lavery (Exhibit 325), his characterization of the interest as a "carve out", or that Billes exercised no management or control over Newmat. However, the characterization of the investment, and Billes' intent in investing in Newmat, are irrelevant. What is relevant is the *fact* that Billes owned (through Marlore) 49% of Newmat's shares and was a director of Newmat, and McAteer knew it. That was sufficient to give her a conflict, without her owning 50+% or exercising management prerogatives. His characterization of the investment as a "carve out" was merely an unsuccessful attempt to limit or screen his knowledge of Billes' interest at the relevant time of the Loan.

2. Effect of McAteer's Knowledge

[201] BJ argued that "nothing turns on a finding that McAteer was unaware of some material interest". I need not respond to that argument in light of my finding that he was aware.

However, had I found that he was unaware of some material interest, I agree with BJ, as it relates to Billes' liability to Mason, although it may have made Billes liable to McAteer. Nevertheless, having regard to my finding that McAteer knew of Billes' interests and undertook to pass the disclosure on to Mason, and obtain her consent to the Loans, it does affect McAteer's liability to Billes for his failure to fulfill that undertaking. McAteer's liability in that regard will be discussed later in this judgement.

[202] As McAteer was aware of the extent of Billes' interest in both Newmat and the Trust, he was able to provide Mason with adequate disclosure of those interests, as I find he undertook to do. If he had advised Mason as to his knowledge of Billes' interests in those entities, it would have amounted to full disclosure, and, if disclosed in writing, would have met the requirements of the USA and the *ABCA*. There would have remained the requirement of Mason's written consent as a shareholder; however, I find McAteer also undertook to fulfill that requirement and failed to do so.

[203] Because McAteer did not make proper written disclosure and get the approval of Mason as he agreed with Billes to do, I find that no disclosure of Billes' interests was provided, as required, to Mason, and her consent to the Loans with that knowledge was not obtained.

3. Billes' Role in the Approval of the Loans

[204] The evidence is that neither Billes nor any shareholder of DDL ever executed a shareholders resolution approving the Loans, nor did any of them get notice of such a meeting. However, while McAteer certified that Billes executed a directors' resolution of DDL for the Trust Loan (Exhibits 36 and 37), there is no evidence of the actual execution of such a resolution. She did execute a DDL directors' resolution for the Newmat Loan, although she says it was executed much later than its date of October 10, 1991 (Exhibits 61, 62 and 306).

[205] In each of the Trust and Newmat Loans it was in issue whether Billes had any authority to execute either type of resolution due to her alleged conflict of interest. I find that she did not have such authority under the USA, unless she specifically abstained from voting on the approval of the Loans.

[206] McAteer, in paragraph 12 of an affidavit dated December 2, 1992 in the McAteer/Kingswood Action (Exhibit 318), complained that Billes voted in favour of the Loans, contrary to the USA. However, I find it does not lie in his mouth to so complain because at the same time I find that he knew of her interest, and was providing the corporate secretarial services that prepared the very directors' resolutions he asked her to execute.

[207] I find that the DDL directors' resolutions authorizing the Loans are inconsistent with the knowledge McAteer had of Billes' interest and the requirements of the USA. Nevertheless, there are resolutions executed, or certified as having been executed, by both him and Billes with respect to the Newmat Loan only (Exhibits 36, 37 and 306). However, Billes believed that

McAteer had taken the appropriate steps to comply with the USA and the *ABCA*. Accordingly, I find she did not know of the breach of the USA.

[208] Mason also argued that Billes knew that she had not signed a shareholders' resolution on behalf of DDL approving either the Trust Loan or the Newmat Loan and that Billes would have known that no meeting had been called to seek approval of either of the Loans. While substantially correct in terms of Billes' entitlement to notice, the reasoning is fallacious because Billes could not have legally signed the shareholders' resolution, except one that noted her interest and her non-participation in the decision (which would have been the proper form to solve all the conflict problems).

[209] However, one must look at the issue from the perspective of Billes as well. A shareholders' resolution could have been signed by Mason to provide consent, without notice or signature by Billes, and, Billes, relying on McAteer's undertaking, and assurances that he had obtained Mason's consent, would have had no reason to check further. It also explains Billes' belief in the content of the Officer's Certificates. Although the Officer's Certificates do not provide her protection under the indoor management rule as a director of DDL *vis-à-vis* Mason, they do in her capacity as a Lender (the Trust) or associated with a Lender (Newmat). In other words, they assist in understanding why she did not enquire further and why she did not know of the breach of the USA. I will explain in more detail *infra*.

[210] This whole debate about Billes' execution of resolutions to approve the Loans was an effort by McAteer to counter the suggestion that McAteer undertook to provide disclosure to and obtain consent from Mason, and to have the Court conclude that Billes merely did not believe she had a conflict, or chose not to deal with it. I reject these suggestions; rather the evidence in this regard corroborates her testimony regarding McAteer's undertaking and representations on the point.

[211] Billes was a sophisticated business person who had several years experience acting as a director of public companies, and was well aware of the duties of a director, and the obligations to disclose a conflict of interest (and how to do so) and the potential consequences of non-disclosure. Additionally, she had actual knowledge of the terms of the USA and her conflict of interest situation - explained to Billes by her counsel, Rita Guthrie, prior to execution April 23, 1990. She also knew from the $54,000 loan transaction in February 1991 that Mason's shareholder consent was necessary when there was a loan from an entity in which she was interested and that McAteer had secured it on that occasion. Billes would have known that she had not signed a shareholders' resolution on behalf of DDL approving either of the Loans and that no shareholders' meeting had been called to seek the approval of those Loans. However, it was reasonable for her to assume that, because of her conflict, and McAteer's undertaking to get Mason's shareholder's consent, Billes' signature thereon was not necessary and that McAteer had done all that was necessary in terms of her disclosure requirements.

4. The Role of the Officers Certificates

[212] In the Officer’s Certificates executed by McAteer for both Loans, more details of which will be provided *infra*, he certified, in substantially identical language, that there was no impediment to DDL borrowing from the Lenders and granting security for the Loans.

[213] I find that these certifications were, to McAteer’s knowledge, absolutely false, as there had been neither written disclosure nor shareholder consent by Mason in accordance with the USA and the *ABCA*. Indeed, he admitted they were false at trial, but merely claimed that there was a “mistake”.

[214] During the same time as the execution of the Officer’s Certificates, I find that Billes genuinely believed that written disclosure had been made to Mason of her interests in the Lenders, and Mason had consented to the Loans. Therefore, Billes argued that she could rely on the Officer’s Certificates executed by McAteer.

[215] It is important to understand what use Billes may make of the Officer’s Certificates. The intent and operation of the “indoor management rule”, discussed *infra*, is, in the simplest of terms, that parties without knowledge of irregularity regarding the management of a corporation, need not make inquiries as to whether all necessary internal approvals within the corporation for a transaction are in place and in order: K.P. McGuinness, *The Law and Practice of Canadian Business Corporations* (Toronto: Butterworths, 1999) at 241-243, 257-258; *J.H. McKnight Construction Co. v. Vansickler*, [1915] 24 D.L.R. 298, at 299-300 (S.C.C.); *Bank of Nova Scotia v. Leblanc*, [1954] 2 D.L.R. 579 (N.B.S.C. A.D.); and *Gray v. Yellowknife Gold Mines Limited and Bear Exploration and Radium Limited (No.1*), [1945] O.R. 688. (Ont. H.C.J.), varied (1947), O.R. 928, at 937 (C.A.). Officer’s Certificates are merely a further protection for third parties, signifying that they have been assured that internal approvals are in order. Therefore, the Officer’s Certificates may be relied upon by Counsel preparing the Loans.

[216] However, F. Iacobucci, M.L. Pilkington & J.R.S. Prichard, in *Canadian Business Corporations* (Agincourt: Canada Law Book Limited, 1977), at 104-106, and Dickerson et al., in R.W.V. Dickerson, J.L. Howard, L. Getz, *Proposals for a New Business Corporations Law for Canada*, Vol. 1, Commentary (Ottawa: Information Canada, 1971), Vol. 1 at 28-29; Vol. 2 at 15, provide that section 18 of the *CBCA* (identical in the *ABCA*), has expanded the protection of the indoor management rule to include persons other than those dealing with a company who are considered outsiders. Accordingly, neither the Trust nor Newmat is precluded from relying on section 18 because of Billes’ involvement with them as a Trustee and director/shareholder respectively.

[217] However, Mason notes the concluding words of section 18 of the *ABCA*, which read "…..unless the person has, or by virtue of his position with or relationship to the corporation ought to have, knowledge of those facts at the relevant time". She argued that, as Billes knew, or ought to have known, that articles. 9.02 and 10.10 of the USA (discussed in more detail *infra*) were clearly a “hindrance” or “restriction” on the powers of DDL and its officers, Billes was unable to rely on either section 18 of the *ABCA* or the Officer’s Certificates.

[218] Billes did have knowledge of the restrictions and requirements in the USA, but had the assurance of McAteer that he had met them. As to the content of the specific Officer's Certificates and Billes' actions in relation to them, Billes testified that she saw the Officer's Certificates and read them at the closing of the Trust Loan and Newmat Loans. While at first blush she may have considered their content to be erroneous having regard to her knowledge and their wording, she had no knowledge that McAteer had not met his undertaking to her. When specifically asked about what her thoughts were when she read Article 5, she said: "Well, the thought was that any provisions of that USA which might hinder had been appropriately dealt with so that there is no hindrance existing at the time of the signing".

[219] To be more specific, it appears that Billes, believing McAteer had disclosed Billes' interest to Mason and obtained Mason's written consent, and both had otherwise executed the necessary internal corporate documents, had no reason for concern, because the consents did not need to be part of the closing documentation for the Loans. Indeed, thinking he had done so, Billes herself relied on the Officer's Certificates executed by McAteer as further confirmation that he had fulfilled his undertaking to her. In this latter regard, Billes argued that, as it related to the Trust Loan in March 1991, "McAteer assured her that Mason had consented and the appropriate resolution would be placed in the DDL Minute Book". Moreover, there is specific evidence that Billes was relying on the Officer's Certificate - she testified that she had Whitlock call Steinberg and as a result the Officer's Certificate was prepared. Further, Whitlock made reference to it at the closing, "satisfying [her] concern". As to the Newmat Loan, Billes' reliance upon the Officer's Certificate is seen in the following passage from her cross by TM:

> I was informed on a phone call that there would be appropriate terms in the documents relative to the Officers' Certificate that would cover off *any concerns that I and Newel might have had about any real or perceived conflict*. [Emphasis added.]

Thus I find that Billes did not have, nor should she ought to have had, knowledge of the internal irregularities. Accordingly, I find that no knowledge was imported to the Lenders via Billes.

E. Entities to Which the Loans Were Advanced

[220] The issue in question was stated in the Outline for Argument thus: "Are there factual issues as to which entity the advance of the funds under the Lenders' Loans were made? If so, what other issues (if any) follow? What is the effect?"

1. Trust Loan

[221] The Trust loan funds of $1.2 million were advanced directly by the Trust to DDL, and deposited to DDL's bank account (Exhibit 41) on February 22, 1991 ($175,000) and March 22, 1991 ($1,025,000).

[222] The intended flow of those proceeds from DDL ($400,000 to Club LP and $800,000 to Developments LP), and the security the Trust held, is set out in Exhibit 37, Tab 1. By way of bank transfer $100,000 was advanced by DDL to Club LP on February 22, 1991 (Exhibit 38). In fact, the lion's share was advanced by DDL to Developments LP on March 22, 1991, $800,000 under a cheque signed by both McAteer and Billes, and $200,000 under a bank transfer (Exhibit 38). McAteer attempted to provide the rationale for this flow of proceeds using the "Kingswood Cash Flow Including Accrued Payables" chart (Exhibit 29). This chart showed advances by Developments LP to Club LP over time to May 1992, apparently based on the construction of the back 9, which Club LP operated on a licence from Developments LP. However, that explanation shed little clear light on the subject, other than to form an alleged support for McAteer's testimony that the funds were "ultimately" advanced to Club LP and Developments LP as intended. As part of the security, DDL assigned the Club LP mortgage to the Trust, through transfers from DDLW to DDL (Exhibits 31 and 37, Tabs 7 - 10).

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[223] Billes says $1 million was advanced under the mortgage, but Mason argued that Exhibit 37, Tab 1, indicates that only $100,000 was advanced.

[224] It is clear that the Trust Loan was made directly to DDL, and that the entire $1.2 million was advanced directly to DDL. DDL in turn advanced $1 million to Developments LP and $100,000 to Club LP. DDL provided the necessary security, including the assignment of a Club LP mortgage for the face sum of $1 million. However, I find that the fact that the ultimate realization by the Trust on the Loan came from that source (the $1 million construction mortgage) does not create a legal issue as to the advance of funds between the Trust and DDL. What issues there may be, if any between DDL and Club LP, is of no interest to the Trust once it made the advance to DDL . Nevertheless, it appears that Mason is correct in noting that $1 million of the proceeds from DDL were initially advanced to Developments LP, and only $100,000 to Club LP, whereas Club LP granted the assignment of the mortgage and was to receive $1 million. While it would have been better for McAteer to have proved by documentation, rather than declaration relying on Exhibit 29, the actual advances from Developments LP to Club LP (McAteer testified it was from DDL to Club LP, but it clearly was through Developments LP), that is the only evidence as to whether the funds were ultimately advanced to Club LP. Mason presented no evidence to the contrary. Moreover, as noted, this would appear to be an internal matter between DDL and the Kingswood Entities, not a matter about which the Trust should concern itself at this stage, especially since it was not raised (or not raised successfully) in the Manitoba foreclosure proceedings.

2. Newmat Loan

[225] As to the $2,100,000 Newmat Loan, funds were advanced directly by Newmat partly to DDL ($1,200,000) and partly to Kingswood Developments ($900,000), as per Exhibit 382. The latter entity was a party to the Loan Agreement and provided a guarantee and mortgage security collateral thereto.

3. Manner of the Advances

[226] In addition to the entities to whom the Loans were advanced, the manner of the advances is of interest.

[227] BJ’s written argument pointed out, as it related to the Trust Loan, that: none of the monies were advanced through BJ; $163,000 was advanced on February 21, 1991 (Exhibits 38 and 41) before BJ prepared any security documentation; $1,000,000 was advanced on March 22nd, 1991, preceding security registrations in Manitoba; and these advances were made without the benefit of any opinion from BJ as to the extent and enforceability of the security.

[228] Similarly, TM’s written argument pointed out, as it related to the Newmat Loan, that the funds were advanced directly by Newmat to DDL and at no time did funds pass through TM's account.

[229] Each argued, in different ways, that the funds were advanced in reliance of the relationship between the parties, they were not dependent upon either any security documentation prepared or registered, or opinions rendered by Counsel. All of this was in support of alternative arguments to the effect that, even if Counsel were implicated in failing to protect the Lenders from Billes’ conflicting interests, the Lenders advanced the funds in any event of the perfection of the security for the Loans or the reliance on Counsel.

[230] None of the advances were made until on or after the date the Loan agreements were executed - on February 22, 1991 as to the Trust and on October 10, 1991 as to Newmat. Nonetheless, some or all of the funds were advanced prior to execution and/or registration of security documentation and reporting by BJ and TM. However, as I have found *infra* that BJ and TM have no liability in the context of Billes’ conflict, these findings are superfluous to the result.

4. Conclusion

[231] Returning to the main issue, McAteer argued that “no consequences flow from the party to which funds were advanced.” I agree, because the debtor, DDL, was the party to whom the Lender advanced the funds. That the debtor provided security through the transfer of a mortgage or other security from another entity is of no consequence to the Lender in the circumstances of this case. The issue of consideration is between DDL and the other entity.

[232] Billes argued that the security was enforceable, even if the principle debt was invalid, which was denied. There are no issues of fact or law in respect of this issue and, in any event, none were pled.

[233] Mason argued that if the principle debt is unenforceable, then the collateral security may likewise be unenforceable. However, as I have found the principle debts from the Loans valid, the issue of enforceability does not arise.

[234] In the result, I find that there are no meaningful legal issues relative to advances which adversely affects the decisions I have made herein.

F. Disposition of the Devoncroft and Kingwood Entities

[235] The issue under this heading appeared in the Outline of Argument in the following way:

> What was the realized value (post receivership/bankruptcy) on the disposition of assets of DDL and the Kingswood entities which are in issue? What are those issues? How do they relate to the decisions that will have to be made in connection with the larger issues which arise in these proceedings? How do they relate to appraised values?

However, I have chosen to deal with this issue *infra,* under "Enforcement and Realization of Security".

G. Personal Benefits Resulting From the Loans

1. Newmat - The $200,000 Loan

[236] The issue was expressed in the outline for argument in this fashion:

> What personal benefits (if any) did McAteer and/or Billes obtain from the Newmat Loan? What evidence supports that finding? What issues arise and how should they be determined in light of that evidence.

[237] The cost to construct the Golf Dome was approximately $1.9 million. Consequently, the amount of the Newmat Loan was to be $1.9 million. However, the Loan was increased to $2.1 million, by the addition of what I have referenced as the "$200,000 Loan".

[238] The benefits to both McAteer and Billes of the $200,000 Loan are seen dramatically in Section 3.02(d) of the Newmat Loan Agreement (Exhibit 67) which provided that the loan advances were to include: "(d) $200,000.00, to be advanced to Martha Billes in partial satisfaction of amounts owed to her by McAteer and to reduce the amount owed to McAteer by the borrower". Further, Section 7.02(j) of the Newmat Loan Agreement (Exhibit 67) specifically prohibited the advance of funds to any officer, director, or shareholder of DDL, except for the $200,000.00 to be advanced to Martha Billes under Section 3.02(d) and except for a monthly draw of $5,000.00 to McAteer (Exhibit 9, p. 27) against amounts owed to him by the borrower[22]. The $200,000 is also an exception (apparently without the consent of the

[22] During the hearing there arose an issue about McAteer's wish in late 1991 or early 1992 to increase this draw to $10,000 - see, for example, McAteer's letter to Billes on July 10, 1992 (Exhibit 90). There was a lot of discussion about this. The general sentiment was that this was another reason for the Lenders to call the Loans. Billes argued that it was expected his salary

Trust, providing further evidence of my finding of Billes' *de facto* control) to Section 5(f) of the Trust Debenture (Exhibit 36), which prohibits DDL from reducing shareholders loans at a rate in excess of $5,000.00 per month without the consent of the Trust. While Billes argued that the funds were, in fact, advanced to DDL and Kingswood first (Exhibit 382), I find that this does not change the substance of the intent and purpose, or ultimate use and effect of the transaction.

[239] Further, Exhibit 377, a letter dated October 10, 1991 from McCarthy Tetrault to Billes, references the increase in the Newmat loan, being $200,000 to permit a repayment to Billes of a $200,000 non-recourse debt from McAteer.

[240] Schematically, as I understand the transactions, they looked something like this:

(a) DDL owed McAteer in excess of $200,000 in shareholders loans;
(b) DDL borrowed an extra $200,000 from Newmat, and paid it to McAteer to reduce the shareholder loan account by $200,000;
(c) McAteer used the funds to pay Billes the $200,000 (roughly) he owed her as his share of the acquisition cost of the Wolfe Street property, which she advanced to him when it was jointly purchased;
(d) Billes paid McAteer the $200,000 (roughly) and McAteer transferred to Billes his interest in the Wolfe Street home; and
(e) McAteer kept the $200,000 and Billes kept the Wolfe Street property in sole ownership.

[241] Ultimately, McAteer received the benefit of the additional $200,000.00 by way of a reduction of his non-interest bearing, unsecured, shareholder's loan due to him from DDL. Mason argued that this was to DDL's detriment because it changed his remaining shareholder's loan into a secured, interest bearing debt by DDL to Newmat. Mason argued that the purpose of the $200,000 Loan was to resolve the dispute between McAteer and Billes with respect to the Wolfe Street property. She pointed out that Billes had held an assignment of McAteer's shareholder's loan for his one half interest in that property, and Billes, in turn, received McAteer's transfer to provide her sole ownership of the property. This was essentially agreed to by McAteer (Exhibit 109). Mason argued that neither McAteer nor Billes gave any consideration to the best interests of DDL *vis-à-vis* these transactions, nor shared the benefits, or granted any equivalent benefits, with or to Mason, the other shareholder. This, Mason argued, in itself, and in combination with Billes' lack of disclosure and the failure to obtain the necessary shareholders'

would stay at $5,000 per month as a return on his shareholder loan. McAteer argued that such an increase was always intended and a bargain. He further argued that it was $10,000 gross, with an intent at $5,000 net after tax, and ultimately he settled for $7,500 gross. I have referenced this elsewhere in these Reasons, but find that, except in the context referenced, it has no great relevance or materiality to the issues I have to decide and, therefore, I will not further recount the evidence or arguments, or make definitive findings in that regard.

approval, constitutes oppression as well as providing grounds for the Derivative Action, both as discussed below.

[242] The issue ultimately therefore is whether these actions by McAteer and Billes constituted evidence of oppression against the remaining shareholder, Mason, and whether they were in the best interests of DDL (the Derivative Action). I agree with Mason on both arguments.

[243] McAteer argued that this was money owing to McAteer by DDL in any event, but concedes that it was "a more rapid payment than may have been contemplated". However, in my view this is part of the problem, having regard to DDL's fortunes at the time.

[244] In my view both McAteer and Billes received a personal benefit from the $200,000 Loan and DDL suffered a corresponding detriment as a result of the conversion of a non-interest bearing, unsecured debt to a secured, interest bearing debt. In my view, this transaction clearly indicates that Billes and McAteer were treating the assets of DDL as though they were their own personal assets. Moreover the last $100,000.00 of this loan was advanced less than two months prior to McAteer's letter on behalf of DDL requesting a reduction in interest and citing difficulty in payment. This would indicate that it was not in DDL's interests to be repaying non-interest bearing shareholder loans when it must have been obvious that DDL was in serious financial trouble. It is certainly indicative that no regard was given to Mason's interest in the Wolfe Street transaction. This will be a basis for consideration under the oppression remedy and in the Derivative Action.

2. The Trust

[245] The issue was not expressed in relation to the Trust Loan. However, Billes argued that "Mason received a benefit from the Trust loan, being the discharge of the $200,000 security in favour of Royal Bank on her personal residence". Mason replied:

> The proceeds from the Trust loan were used partially to reduce corporate debt and not to benefit Mason. Pursuant to the provisions of paragraph 8.03 of the Separation Agreement between Mason and McAteer (Exhibit 28), McAteer had an obligation to discharge the security on Mason's personal residence. There is no evidence that Mason had knowledge of the source of funds used to discharge this obligation nor was she cross-examined at trial on this matter. It is respectfully submitted that if there was a benefit attributable to the use of these funds, then it is a benefit attributable to McAteer in the sense that it enabled him to meet a personal obligation.

I agree with the effect of this response. There was no payment to Mason, but merely a payment to the Royal Bank, through McAteer, which allowed the security on the Mason residence to be removed. At worst, no one can complain because all the shareholders of DDL agreed - Mason indirectly by the Separation Agreement, without her specific knowledge of the source or manner of the removal of the security, and McAteer and Billes by the use of the funds to pay down the

Royal Bank, which also accomplished McAteer’s covenant to Mason. This was neither a cost to DDL nor a prejudice to any shareholder and is therefore not relevant to the Derivative Action or the oppression remedy.

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H. Did TM Act for Newmat?

[246] The issue was stated in the Outline for Argument in these terms:

> What entity did Taylor McCaffrey act for on the Newmat Loan? If more than one entity, what entities, when did they act, and for what purpose(s)? Who retained Taylor McCaffrey in relation to the Newmat loan? What were they retained to do? How are the answers to these issues relevant to their liability (if at all)?

[247] The short answer is I find that, even though it may also have acted for the borrower DDL in some senses, TM primarily acted as Counsel for Newmat on the Newmat Loan. In that regard it acted for the purpose of: documenting the transaction, documenting the security, attending to execution of same, registering the security and reporting that the security documentation evidencing the transaction had been validly registered. The only aspects of a “normal” transaction that I find were missing are that TM had no responsibility for handling advances of the Loan, nor was it asked to provide an opinion as to whether the Loan documentation and security was legal, binding and enforceable. However, I find that the retainer was such that, had there been any knowledge that the latter did not apply, there was a duty to disclose it. I believe that this is descriptive of the responsibility (or “retainer”) that TM had *vis-à-vis* Newmat: *Spence* v. *Bell* (1982), 39 A.R. 239 at 245 (C.A.); and *Smith v. McInnis*, [1978] 2 S.C.R. 1357 at 1360-61, (sub nom. *Webb Real Estate Ltd. v. McInnis,* also *Patterson Smith Matthews & Grant v. McInnis Meehan & Tramble*). Moreover, I find that TM satisfied this responsibility.

[248] While the majority of the evidence Marshall gave on behalf of TM was credible, the position that he took with respect to whether TM acted for the Newmat interests on the Newmat Loan was incredible.

[249] I accept the evidence of Marshall that: it was McAteer who contacted TM to “put together paper for a new loan transaction”, or to “paper the transaction”; he received some instructions from McAteer; and the account for legal services was sent to DDL; TM provided no opinion concerning the security, nor was such an opinion ever requested; and no loan funds ever passed through TM’s account. However, I find that TM was retained, perhaps in addition to representing the interests of the borrower, DDL, to represent the interests of the lender, Newmat, in the Newmat Loan.

[250] While TM received some instructions from McAteer, as McAteer had drafted the proposal which was (generally) acceptable as the Loan, I find that TM also received significant instructions from Newal, Lavery, on Billes’ behalf, and, to a much lesser extent, Billes herself.

In preparing the final draft documentation and last minute changes prior to execution, Marshall acknowledged that (Exhibits 372-3).

[251] However, it is most significant, in my view, that the reporting on the execution of the Loan and registration of security was proposed to be (Exhibits 374 and 375), and was, together with the originals of the security documents, to Newmat (Exhibits 85, 375, 376, and 460 -462). This is as it should have been as Counsel was retained to protect the interests of the lender, notwithstanding that copies of the closing documents and report are also generally provided to the borrower (Exhibit 327).

[252] In addition, Marshall, *inter alia*: incorporated a Manitoba numbered company (2809291 Manitoba Ltd.) on behalf of Newmat; acted for Newmat and the numbered company 280 in preparing an agreement of trust; acted for Newmat and 280 in registering their security; signed the security registration documentation as solicitor on behalf of Newmat (Exhibit 468); registered a caveat for 280, describing himself as solicitor and agent for 280 (Exhibit 467); acted as attorney for service for 280 (Exhibit 380); and reported to Newmat on February 24, April 15 and May 11, 1992 (including Exhibit 85), advising Newmat the Golf Dome mortgage represents a first registered charge. Indeed in Exhibit 85, while it may have been a “boilerplate” type of wording, as Marshall testified on cross by Billes, Marshall does thank Newmat “for allowing us to attend to this *on your behalf*”.

[253] While DDL was billed for the legal services (Exhibit 327), that is not unusual. Indeed, as Lavery noted in his evidence, it is commonplace for the borrower to pay the legal fees of the lender on commercial loans, as was provided in this case under the terms of the Loan Agreement (Exhibit 67, paragraph 7.01(c).

[254] Billes argued, and I agree with the following comments:

> ... Marshall acted for Newmat and 280, on aspects of the transaction beyond mere document preparation; that Marshall made recommendations as to who should hold the security documentation, made applications for the necessary orders to register the security on farmland, attended to the registration on behalf of Newmat or 280, and provided reports of his activities to Newmat; ... It is not accurate to say that he was merely retained solely by DDL or only to prepare documentation.

[255] TM was clearly retained to protect the interests of Newmat and to make sure that the loan documentation and security protected Newmat in the transaction. TM and Marshall should have acknowledged this responsibility, and Marshall lost credibility in not doing so. It is fortunate for Marshall and TM that there is little else in conflict for which I need to weigh his credibility. This lack of credibility does not affect my finding that Marshall lacked knowledge of the nature of Billes’ interest in Newmat and of the terms of the USA, such that Newmat can, based on the Officer’s Certificate, take advantage of the indoor management rule.

[256] TM argued that: “[a]t no time did the TM retainer include making inquiries into the role, status, or knowledge of the DDL directors much less the shareholders of DDL.” I find that, but for the right to rely upon the indoor management rule, having regard to the fact that the retainer was unlimited, it did include such matters. However, TM met this obligation by reliance on that rule.

[257] TM argued that:

> TM viewed their retainer to include registrations required in relation to the documents. This included acting for 280 and Newmat for the limited purpose of effecting the registrations. This limited purpose retainer was not uncommon in Manitoba in order to effect registrations.

Billes argued as to this contention that:

> ... while the writings do pertain primarily to security registration, the retainer was creating and confirming the validity of the loan documentation or at least the security.
>
> It was TM's responsibility, if it believed it was dealing with an unrepresented person, to make that clear. It is submitted that the same obligation applies to a lawyer who undertakes a limited retainer, at least in circumstances where the client may believe that the retainer is wider. TM acted for Newmat, and took no steps to advise Newmat of any limited retainer or to advise Newmat that it should obtain counsel.

[258] I have determined that TM acted for the Newmat interests and that ends the issue. However, had I not so determined, I agree with Billes that there would have been a duty on TM to advise Newmat of its belief in a limited retainer, such that TM would be estopped from denying that they had acted on a full retainer, or alternatively, might well have been found negligent in not doing so. While it might well have been the practice in Manitoba to act on registration only when it was clear to all that this was all that was being done (although no Manitoba legal expert was called to so testify), I do not accept, on the evidence before me, that such a practice in Manitoba was applicable to the circumstances of this case.

[259] I find further, supported by the evidence of Newell, that Spence was only retained regarding the loan from the ATB to Newmat (Exhibit 60) and for the authorizing resolutions on the Newmat side of the loan, and not in respect of the Newmat Loan to DDL itself. As such, he was concerned about the conflict issue in the ATB loan to Newmat and not in the Newmat Loan to DDL. Accordingly, he discussed it with Billes and made certain that there was no problem. Spence had no duty to satisfy himself as to DDL’s conflicts as I find and as Lavery believed, Spence was not acting for Newmat with respect to the Newmat Loan. Nor was he responsible for obtaining security from DDL. He was, as it relates to the Newmat Loan, only acting on the

“corporate governance” from Newmat’s perspective. In effect, he was acting for ATB interests regarding the ATB loan to Newmat.

[260] I find that the duty to protect the Newmat interests under the Newmat Loan was TM’s, and was met by their reliance on the indoor management rule, including reliance on the Officer’s Certificate. The discussion of the problem of conflicts on October 2, 1991 by Spence with Billes as between ATB and Newmat, should have alerted her to a problem as between Newmat and DDL. However, she had no reason for concern in this regard as McAteer represented that he was looking after any issues of conflict. In any event she spoke with Marshall on or about October 4, 1991, and, I accept his evidence that she did not raise the issue with him.

I. The Role of Billes in Relation to Devoncroft

[261] The issue was expressed in the outline for argument in this fashion:

> “Was Ms. Billes brought into DDL as a "financial partner"? Did she agree to take on any specific responsibilities relating to financing of DDL, or the Kingswood Entities”?

I find that the answers are “Yes” and “No”, with an appropriate understanding of what “financial partner” means.

[262] McAteer and Mason gave evidence that they understood that Billes was brought in as a “financial partner”. In July 1992, after the personal relationship was at an end and the business relationship in serious trouble, McAteer defined what he meant by this status (Exhibit 109):

> At least from my perspective it is fair to say that financial partners would be expected within the industry to assist the business by:
> - Assisting with Bank financing
> - Arranging outside financing and partners as required to fund commitments we, as directors, made
> - Being the lender of last resort
> - Providing the cash safety net

In the same document McAteer alleged that Billes worked against, and had not met the expectations due, DDL:

> As lender of last resort you have involved outside consultants which have negotiated high premium rates, charged very high fees and provided terms which were harsh and in one case illegal and unenforceable under the laws of Canada.
>
> Except with respect to the advances from Albikin, you personally, have not loaned DDL money as a safety net in sufficient amounts to prevent defaults on key loans within DDL. Also, we have failed to pay our key suppliers in some cases on accounts 9 months in arrears because of a lack of adequate financing.

> You have referred to Albikin as a crutch. A financial partner is exactly that, a lender of last resort and a crutch when times are difficult.

[263] As the evidence of Harms indicates, McAteer was quite cavalier about Billes' "financial partner" role. Mason went further, arguing:

> McAteer's evidence is that Billes was brought in as a financial partner. Mason had a similar understanding. The evidence of Billes is that she was expected to make contacts with financial institutions in an attempt to gain financing for DDL. It is not in dispute, that some financial institutions were prepared to grant financing only on the strength of personal guarantees from Billes and McAteer. Billes refused to provide a personal guarantee and thus financing was not received. It is open to the Court to determine it was impliedly understood that Billes, as a financial partner or as a director, would provide her personal guarantee to ensure that DDL was able to obtain financing to implement the business plan developed by DDL's directors.

McAteer was less specific, implying that, by her actions, Billes agreed to provide funding as necessary, quoting her letter (Exhibit 55) of September 22, 1991, where she stated: "I am prepared to have the funding provided to see the dream realized".

[264] Billes replied:

> Billes was brought into the relationship under the terms of the written agreement (Exhibit 11[23]). She had no legal obligations beyond that. Billes was investing funds and McAteer was responsible for the operations. There may have been an expectation by McAteer and Mason, to provide further funds from time to time. This does not equate to an obligation on Billes to do so.
>
> ... There is no evidence before the Court that provision of guarantees was ever discussed in the formation of the initial investment.

Later in argument, Billes added:

> ... that the submissions of Mason ... in this regard amount to the proposition that Billes was under some type of obligation to continue as a financial crutch to DDL, when neither Mason nor McAteer were able or willing to put any further financial support into these companies. No such obligation exists.

I agree, and would go farther, namely, that I do not recall any evidence of Billes ever agreeing to grant personal guarantees at anytime, although McAteer sought this when it was suggested by

[23] *Sic* - I believe Exhibit 12A was what was intended.

potential lenders from time to time. Her comments in her letter of September 22, 1991, I find were limited to the loan then under discussion, which manifested itself in the Newmat Loan.

[265] Regardless of McAteer's or Mason's terminology or expectations, or the ability of McAteer to convince Billes to provide funds, as Billes did (indirectly) in the Lenders' Loans, and directly in smaller amounts on other occasions, I do not find that the fact Billes was brought in as a "financial partner" translated into any agreement or legal obligation on Billes to continue to provide funds to DDL. Nor is there evidence that Billes agreed to provide personal guarantees or any other assurance that DDL would be able to obtain financing on an ongoing basis. Indeed, I find that she specifically did not.

J. The Proposed Loan from Household Trust

[266] The issue was expressed in the Outline for Argument in these terms:

> Did Billes induce McAteer, DDL or the Kingswood entities not to proceed with the loan from Household Trust for any of the improper purposes alleged? What evidence supports/detracts from that conclusion and what, if anything, turns on it?

[267] McAteer submitted that the proposed loan from Household Trust (Exhibit 307) would have been used to pay out the Trust Loan sufficiently to allow the Trust to readvance the funds for use on the Golf Dome. However, Billes rejected the proposed Household Trust loan and offered to loan funds through Albikin, later changed to Newmat. McAteer claimed that Billes had improper motives for rejecting the Household loan and that her true motivation was to gain control of DDL and Kingswood.

[268] Billes contended that the Household loan was proposed to Kingswood, not DDL, and that she had no authority to prevent the loan. Moreover, it was argued that she expressed her disagreement due to a number of unreasonable terms, including that: the Trust Loan security be subordinated; Billes would have had to provide a guarantee; the amount of $700,000 was insufficient to pay out the Trust Loan or to finance the Dome; and it required a $100,000 letter of credit from Kingswood, which was unlikely to be obtained. Accordingly, it is argued that there is no foundation to McAteer's claim. I accept and agree with Billes' submissions in this regard, and accordingly find that Billes did not induce McAteer, DDL or the Kingswood entities not to proceed with the loan from Household Trust for any of the improper purposes alleged.

K. Other Factual Issues

[269] The parties were invited to address other factual issues. Some of them have been dealt with directly or indirectly elsewhere in these Reasons. I find it unnecessary to address the others except one, although I do not believe it is a "show stopper".

1. Adverse Inference for Not Calling Gary Curtis as a Witness

[270] Gary Curtis might have been able to provide valuable evidence regarding, *inter alia*, the Alleged Agreement. Namely, he may have been able to shed light on whether there was a limitation on the ability to enforce security on the $1,000,000 construction mortgage. In this regard, Billes argued:

> McAteer submits that an adverse inference should be drawn from the fact that Billes *et al.* did not call Curtis as a witness. The witness list was for scheduling purposes only and specifically stated that listing a witness on the schedule did not imply any obligation to call that witness. In earlier versions of the witness schedule, Gary Curtis was shown as a witness to be called by McAteer and by the Billes' defendants. Neither decided to call him.
>
> The witness was available to any party and in such circumstances no adverse inference can be drawn against any party: Sopinka et al., *The Law of Evidence in Canada*, 2nd ed. (Toronto: Butterworths, 1999) at para. 6.321. See also *MacMaster (Litigation Guardian of)* v. *York (Regional Municipality)* (1997), 42 M.P.L.R. (2d) 90 at 96 - 98 (Ont. G.D.), aff'd trial judgment with respect to costs [2000] O.J. No. 2941 (C.A.) for a review of a number of authorities.

I agree, but would add that the inference in law exists only when, to use the words of E. Macdonald J. in *MacMaster*, the witness is one "who was particularly and uniquely available to that party". I find that Gary Curtis was available to be called by any party.

VII. ONUS OF PROOF

[271] In the Outline for Argument, the Court acknowledged the general rule regarding onus and asked Counsel to make submissions on any special considerations in that regard. Specifically, the issue was stated thus:

> "The general rule [that] the one who asserts must prove on a balance of probabilities is not in issue. However, the parties should address any special considerations that are specific to the matters in issue."

[272] As postulated, while the general principle is not in issue, the onus of proof in relation to a number of specific issues raised herein requires additional consideration. Those issues include:

(a) was disclosure of Billes' interest in the Lenders made to DDL's shareholders;
(b) would the DDL shareholders have approved the Loans had appropriate disclosure been made;
(c) were reasonable steps taken to obtain fair market value for the DDL/ Kingswood assets; and
(d) is an oppression remedy appropriate?

A. Disclosure of Conflict of Interests

[273] I find that what constitutes adequate disclosure will depend in each case upon the nature of the agreement proposed and the context in which it arises. However, it will generally require full information of the real state of things: *Gray v. New Augarita Porcupines Mines Ltd.*, [1952] 3 D.L.R. 1 (P.C.). The disclosure must be more than merely that there is an interest; it should include what the interest is and how far it goes: *Imperial Mercantile Credit Ass'n v. Coleman* (1873), L.R. 6 H.L. 189, at 201 (H.L.).

[274] The issue of which party has the burden of proof in relation to whether adequate disclosure has been made is not as simple a question.

[275] McAteer and Mason cited *Charles Baker Ltd. v. Baker & Baker*, [1954] O.R. 418 (C.A.) and *Gray v. New Augarita*, as authority for the submission that Billes carries the burden of establishing that the transaction was a righteous one.

[276] In *Baker*, the Court was dealing with a breach of fiduciary duty in the context of an employment relationship. There the company took the position that the defendant employee had secured a profit by entering into a transaction which he had learned of as an agent of the company, a transaction which the company argued it would have taken advantage of itself had it been aware of all of the material circumstances.

[277] In *Baker*, the Court of Appeal held, at 429, that the issue was whether:

> ...an agent of the appellant company and therefore in a fiduciary relationship to it, entered, in the course of his agency, into a transaction in which there was utilized the position and knowledge possessed in virtue of the agency, and whether the transaction resulted in a profit to the agent.

The Court held further, at 432:

> The onus is upon the agent to prove that the transaction was entered into after full and fair disclosure of all material circumstances ... The burden of proof that the transaction was a righteous one rests upon the agent, who is bound to produce clear affirmative proof that the parties were at arm’s length, that the principal had the fullest information upon all material facts, and that having this information he agreed to adopt what was done.

[278] McAteer also relied on *Gray v. New Augarita* in support of his submission that Billes has the onus in relation to this issue. *Gray* held that a director who wishes to keep the benefit of some transaction involving the corporation has the onus to establish that he has satisfied all the necessary conditions.

[279] However, D. Peterson, *Shareholder Remedies in Canada*, (Looseleaf) (Vancouver: Butterworths, 1989), stated, at para. 13.9, that *Gray* does not relate to the onus of proof at the time of an application to set an interested contract aside. Rather, it is a statement relating to the duty to ensure compliance with the self interested contract rules at the time such a contract is entered into.

[280] Although contrary to her position, Mason also cited D. Peterson at para. 13.9, where, later in that paragraph he states:

> Unless provided otherwise, it is presumed that a civil standard of proof is required, with the onus of proof on the corporation or shareholder to set aside the interested contract. The applicant seeking such an order must therefor provide, on the balance of probabilities, that a director or officer is interested in a contract which is "material" and has failed to do *any one of* (a) disclose his or her interests as required by the section; (b) obtain approval of the directors or shareholders, as the case may be; or (c) establish that the contract was reasonable and fair to the corporation at the time it was approved. [Emphasis added.]

[281] Billes submitted that the onus here is the same as it would be in any case where the borrower disavows a loan - it is on the plaintiff. She relied on *Teck Corporation Ltd. v. Millar* (1972), 33 D.L.R. (3d) 288 (B.C.S.C.) as authority for that proposition. That case states simply that the onus is on the plaintiff to demonstrate that the directors failed to act in good faith by showing that they had no reasonable grounds for believing that a particular action was not in the best interests of the company. Given that we are here dealing specifically with an interested transaction and the violation of both the *ABCA* and the USA, I find that case to be of limited assistance. Billes submitted further that that onus obliges McAteer and Mason to demonstrate that:

> (a) there was non-compliance with the *ABCA* or the USA;
> (b) if there was non-compliance, it affects agreements, undertakings or security provided by DDL or the Kingswood entities; and
> (c) each lender is a person who has or ought to have knowledge that any USA has not been complied with or that a person held out as a director, officer or agent has no authority to exercise the powers and perform the duties that the director, officer or agent might reasonably be expected to exercise or perform (*ABCA*, Section 18; *Corporations Act* (Manitoba), Section 18).

I note that no authority was provided by Billes in this regard.

[282] Billes argued that the authorities submitted by Mason and McAteer were distinguishable from the present case on the basis that the Lenders were distinct entities from Billes as a result of the separate entity principle. She relied on *Bank of Montreal* v. *Canadian*

Westgrowth Ltd. (1990), 102 A.R. 391 (Q.B. - Brennan J.), aff'd (1992), 135 A.R. 49 (C.A.) and *Cunningham v. Hamilton* (1995), 169 A.R. 32 (C.A.), as authority for the separate entity principle. In essence, she submitted that as she was not a party to the Loans, she obtained no personal benefit from the Loans. She stated further that it is only the independent Lenders, whom Billes argued she did not control, that wish to keep the benefit. On that basis, Billes submitted that the onuses of proof submitted by McAteer and Mason have no application to the present circumstances.

[283] In addition to the authorities cited by the parties, the issue of onus has also been considered by Moore C.J. in *Imperial Trust Co. and Taylor Assets (Dominion) Ltd. v. Canbra Foods Ltd.* (1987), 78 A.R. 267 (Alta. Q.B.). In that case the Plaintiff sought court approval of an arrangement under section 186 of the *ABCA*. The arrangement concerned a proposed transaction wherein six members of the Canbra management wished to acquire the shares of the majority shareholder of Canbra. At a board of directors' meeting a resolution was introduced to put the Plan of Arrangement to the shareholders. The two interested directors voted in favour of the resolution and the other three directors present at the meeting, who were outside directors, abstained from voting.

[284] In considering whether full, fair and plain disclosure was made, Moore C.J. found that, although the interested directors had disclosed their interests in the transaction, they had failed to provide adequate disclosure in relation to the material financial information. He specifically stated that such disclosure was included in the duty to make full, fair and plain disclosure and, accordingly, the disclosure to the shareholders was inadequate. He stated further that the directors' disclosure of their material interest did not excuse the financial disclosure.

[285] On the issue of onus, the Court stated that the onus was on the interested directors, as the Group forcibly taking the shares of the minority, to satisfy the Court that the circular was fair. Thus, *Imperial*, would seem to suggest that the onus, in the present case, would be on Billes, as the interested director.

[286] I note that the case law appears to be consistent with the views of H. Sutherland, *Fraser and Stewart: Company Law of Canada*, 6th ed. (Toronto: Carswell, 1993), where he states at page 428:

> The onus lies on the director to show that he has complied with the [the full disclosure] conditions of such a by-law or article...

[287] I agree with D. Peterson that the onus consists of demonstrating that a director or officer is interested in a contract which is "material" and has failed to do any one of: (a) disclose his or her interests as required by the section; (b) obtain approval of the directors or shareholders, as the case may be; or (c) establish that the contract was reasonable and fair to the corporation at the time it was approved. This is consistent with the language of section115 of the *ABCA*.

[288] With respect to who bears that onus, there is a clear disagreement among the authorities. While the case law appears to suggest that the onus is on the directors, D. Peterson's view is that it remains on the applicant, unless provided otherwise. See also: *Denman v. The Clover Bar Coal Company* (1913), 48 C.R. 318.

[289] In the circumstances, it is not necessary for me to finally determine the issue as I find, on the evidence, that Billes has failed to show that the statutory requirements were fulfilled and Mason has demonstrated that they were not. Accordingly, it would not matter which party bore the onus in the current circumstances as the result would have been the same in either case. Therefore, I leave resolution of who hears the onus to another case.

B. Would DDL have Proceeded with the Loan Transaction If There Had Been Disclosure

[290] Mason argued that the onus was on Billes and McAteer to prove that, even with the disclosure of material facts, the shareholders would have proceeded with the Loan transactions and that more than mere speculation is required. In that regard she relies on *Commerce Capital Trust Co. v. Berk* (1989), 68 O.R. (2d) 257, at 260-62 (Ont. C.A.), varied (1989), 69 O.R. (2d) 735 (C.A.).

[291] *Berk* is factually distinguishable from the case at hand as it deals with a lawyer's failure to disclose material facts to a client, but this does not change the principle. In any event, relying on speculation, rather than proof on a balance of probabilities, is clearly inappropriate. The entire civil justice system is premised on a balance of probabilities burden of proof. There is no reason why speculation would be sufficient in relation to this particular allegation.

[292] Therefore, the onus is, as is generally the case, on the party asserting to prove. The standard of proof in this regard is on a balance of probabilities.

C. Realization of Fair Market Value

[293] As to the realization of the debtor's property by a creditor, it is necessary to review the conduct of the disposition. Where the creditor and subsequent purchaser are somehow related, the creditor has a heavy onus to satisfy the Court that the disposition was made in good faith and that the creditor took all the necessary steps to obtain the best price that was reasonably obtainable at the time: F. Bennett, "Creditors' Duty of Care On Realization", in *LSUC Special Lectures, 1988: Rights and Remedies in the Law of Creditor & Debtor,* 247 at 253-58, 271-83, relying upon, *inter alia*, *Cuckmere Brick Co. and another v. Mutual Finance Ltd.,* [1971] 2 All E.R. 633 (C.A.), *Bank of Montreal v. Petronech* (1984), 52 C.B.R. (N.S.) 17 (Alta. Q.B.), and *Tse Kwong Lam v. Wong Chit Sen and others,* [1983] 3 All E.R. 54 (P.C.). Bennett, at 273 - 83, also lists numerous factors that may be taken into consideration to determine whether reasonable precautions were taken to obtain true market value.

D. Solicitors' Negligence

[294] With respect to the third party claims against BJ and TM, the onus is on Billes and the other named Defendants to show that the lawyers failed to live up to the standard of care expected of a reasonably competent solicitor in the circumstances. The claimants have the onus of demonstrating the standard and a non-compliance with the standard. This is usually established through an expert, although none were called by the claimants in this case.

[295] More specifically, the onus is to establish that the lawyers, knowing of a real or alleged material interest or potentially problematic provisions of a USA, failed to warn the Lenders of the risk involved, and that had the Lenders been properly warned or advised of the risk, they would probably have taken a different course of action. However, the application of the standard is relatively lax and any uncertainty must be construed against the solicitors. Ultimately, the issue is not whether the lawyers make a mistake, but whether or not they were negligent: *Major* v. *Buchanan* (1975), 9 O.R. (2d) 491 at 514 (Ont. H.C. - Goodman J.); *285614 Alberta Ltd and Maplesden.* v. *Burnet, Duckworth & Palmer, and Spackman* (1993), 139 A.R. 31 at 35-39 (Q.B. - Russell J.); *Central Trust* v. *Rafuse*, [1986] 2 S.C.R. 147 at 207-214, varied [1988] 1 S.C.R. 1206; and *Schloss* v. *Knaut* (1979), 107 A.R. 96 at 97 (C.A.). As no "absolute liability" is sought to be imposed, TM's reliance on *Midland Bank P.L.C.* v. *Messrs Cox McQueen*, [1999] E.W.J. No. 103, (C.A.), online: QL (EWS) need not be discussed.

[296] BJ also argued that the claimants against the third parties have the additional onus of proving that any loss was a direct and foreseeable consequence of any breach of duty of the third parties. In light of my findings, I need not address this issue.

E. The Oppression Remedy

[297] Under the oppression remedy, the onus is on Mason to prove that the acts of Billes, and/or McAteer, were oppressive, unfairly prejudicial, or unfairly disregarded her shareholder interest. The standard of proof is on a balance of probabilities: *Wind Ridge Farms* v. *Quadra Group Investments Ltd.* (1999), 180 Sask.R. 231 (C.A.); D. Peterson, at paragraph 18.18 and cases cited at footnote 2 thereof.

[298] Given the weight of authority to the effect that the onus is on the applicant, I am compelled to apply that onus in the case at hand. I would note, however, that D. Peterson suggests, at para. 18.19, that it would be sensible to place a *prima facie* onus on the applicant, such that, once a *prima facie* case is made out, the onus would shift to the alleged oppressor. He states that support for this proposition appears in both English and Canadian Courts. In terms of Canadian cases he cites only: *Brant Investments Inc.* v. *KeepRite Inc.* (1991), 3 O.R. (3d) 289 (C.A.), where he stated that the Court expressed support for this proposition in *obiter*; *Re Bury and Bell Gouinlock Ltd.* (1984), 48 O.R. (2d) 57, at 59 (H.C.J.), stayed pending appeal (1984), 48 O.R. (2d) 374 (H.C.J.), aff'd on appeal (1985), 49 O.R. (2d) 91; and *Re. Abraham*

and Inter Wide Investments Ltd. (1985), 51 O.R. (2d) 460 (H.C.J.), varied (1988), 66 O.R. (2d) 684 (H.C.J.).

VIII. KEY ISSUES

[299] The Outline for Argument posed a detailed series of questions under various scenarios relating to the allegations of conflict and disclosure under the USA, *ABCA* and at common law, relative to the validity of the Loans. The considerations were to be separately addressed in relation to the Trust Loan and the Newmat Loan, but often the focus was first on the Trust Loan, with only incremental arguments in relation to the Newmat Loan.

[300] The key issues in this litigation parallel the various actions: the McAteer/Kingswood and Mason Actions challenge the validity of the Loans; the Mason Action also alleges oppression by McAteer and Billes against Mason; and the Derivative Action claims breaches of fiduciary and legal duties by McAteer and Billes to DDL, including failure to act honestly and in good faith with a view to the best interests of DDL.

IX. DISCLOSURE OF INTEREST, VALIDITY OF LOANS AND RESULTING CONSEQUENCES

[301] The primary focus of the McAteer/Kingswood and Mason Actions is on the obligation of Billes under the USA, the *ABCA* and at common law, to disclose her interest in the Trust and Newmat Loans, whether she fulfilled those obligations and the appropriate consequences of any failure to disclose. This latter consideration concerns the validity of the Loans and the security, the terms of any remedy to which Mason or McAteer may be entitled as shareholders, and the liability (if any) of the Third Parties. There are a host of other issues, but this section will focus on those primary issues.

[302] As above, similar issues arise in relation to the Trust and Newmat Loans. Accordingly, much of the analysis focuses on the issues without distinction between the Loans, except where the facts necessitate separate consideration.

[303] The Outline of Argument, modified to combine both Loans, reads:

> A. Trust and Newmat Loans - Conflict/Disclosure
>
> 1. Did Billes have a legal obligation to disclose her relationship to the Trust/Newmat? Why/why not? As to Newmat, if so, what aspect - her directorship? shareholding through Marlore? Both?
>
>   a. Under the USA
>   b. By Statute
>   c. At Common Law

2. If 1. is affirmative, did Billes disclose her relationship *as required*? Did Billes disclose her relationship, but not as required?

   a. Under the USA
   b. By Statute
   c. At Common Law

3. If 2. is negative, is Billes' failure to disclose her relationship as required, excused or does the Court have a discretion to provide a remedy? If so, why or by what reason(s) (in fact or law)?

4. If 2. is positive, or if that requirement is excused under 3., is the security still invalid due to a lack of shareholder approval?

5. If 3. is negative, or 4. is positive, what are the consequences (and why) to:

   a. The Trust, Newmat & DDL
   b. Security granted by Kingswood Entities
   c. BJ and TM

      i. If there are consequences to BJ or TM, is any failure by BJ or TM excused, or are they liable to Billes *et al* and thereby responsible to contribute (in whole or part) to any damages payable to any other party? If so, why (in fact or law)?

   d. Others

6. Does a remedy(ies) follow from the above? If a remedy(ies) results from the above, what is/are the appropriate remedy(ies), what finding of liability, and why? How are they to be assessed/distributed?

B. Trust/Newmat Loan - Other Validity Issues?

1. Is there any other reason why the Trust or Newmat Loans may be invalid?

2. If the answer to 1. is positive or negative, what are the consequences to the various parties?

3. Are there any issues relating to the fairness and reasonableness of the Trust or Newmat Loans to DDL? If so, what are they, and what relevance do they have to the validity of the loan or otherwise?

I do not intend to proceed in lock step with this Outline, but will provide answers to these issues in this section.

A. Executive Summary

[304] Before getting into the analysis, I will review the position of Mason and summarize the result to which I have come. McAteer and Mason argued that the Loans were invalid and void or voidable. I do not agree. Mason argued throughout that it would be appropriate to rectify all liabilities under the oppression remedy, and that Billes, McAteer, the Trust and Newmat ought to be directly jointly and severally liable to compensate her in an amount equal to the loss of the value of her shares in DDL at the time of the oppressive conduct. While I do not agree with the allegations of liability against the Trust and Newmat, for reasons that will be apparent later in these Reasons, I otherwise agree. That is, I find the Trust and Newmat Loans are not invalid, and that it would be appropriate to rectify all liabilities under the oppression remedy with Billes and McAteer jointly and severally liable to compensate Mason in an amount equal to the loss of the value of her shares in DDL at February 22, 1991.

B. The USA and the *ABCA*

[305] The analysis should start with the provisions of the USA and the *ABCA*. The relevant portions of the USA (Exhibit 13) read:

> 9.02 Corporate Borrowing.
> Except with the unanimous consent of the Board of Directors:
> (I) The corporation shall not be entitled to borrow or become indebted (excluding trade payables and obligations under operating leases) to any Person or Persons in an aggregate amount outstanding at any one time in excess of five hundred thousand dollars ($500,000.00); and
>
> . . .
>
> 10.10 Conflict of Interest
>
> (a) A Director or officer of the Corporation who:
>
> (i) is a party to a material contract or proposed material contract with the Corporation;
>
> (ii) is a director, officer or employee of or has a material interest in any Person who is a party to a material contract or proposed material contract with the Corporation...
>
> *shall disclose the nature and extent of his interest at the time and in the manner provided in respect of material contracts in the Act. . . .No such Director of the Corporation shall vote on any resolution to approve a contract referred to* in paragraphs (i) or (ii) above. . .

> (b) If a material contract is made between the Corporation and one or more of its Directors or officers, or between the Corporation and other Person of which a Director or officer of the Corporation is a director, officer or employee or in which he has a material interest, (i) the contract is neither void nor voidable by reason only of that relationship . . . if the Director or officer disclosed his interest in accordance with the provisions of the Act and the contract was approved by the Directors or the Shareholders as may be required and it was reasonable and fair to the Corporation at the time it was approved.
>
> (c) Notwithstanding anything else herein contained, *if* in connection with any matter fifty per cent *(50%) or more of the Directors are disqualified from voting on such matter as a result of the provisions of this section or the Act, such matter shall be referred to and decided by a resolution of the Shareholders.* [Emphasis added.]

[306] The portions of the *ABCA*, relevant to conflict of interest include:

> 115(1) A director or officer of a corporation who
>
> > (a) is a party to a material contract or proposed material contract with the corporation, or
> >
> > (b) is a director or an officer of or has a material interest in any person who is a party to a material contract or proposed material contract with the corporation,
>
> *shall disclose in writing* to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his interest...
>
> ...
>
> (7) If a material contract is made between a corporation and one or more of its directors or officers, or between a corporation and another person of which a director or officer of the corporation is a director or officer or in which he has a material interest,
>
> > (a) the contract is neither void nor voidable by reason only of that relationship...
>
> ...if the director or officer disclosed his interest in accordance with subsection (2), (2.1), (3), (4) or (6), as the case may be, and the contract was approved by the directors or the shareholders and it was reasonable and fair to the corporation at the time it was approved.

> (8) *If a director or officer of a corporation fails to disclose his interest in a material contract . . .the Court may, . . . set aside the contract on any terms it thinks fit.*
>
> (9) This section is subject to any unanimous shareholders agreement. [Emphasis added.]

[307] The portions of the *ABCA* relevant to oppression include:

> 234(1) A complainant may apply to the Court for an order under this section.
>
> (2) If, on an application under subsection (1), the Court is satisfied that in respect of a corporation or any of its affiliates
>
>> (a) any act or omission of the corporation or any of its affiliates effects a result,
>>
>> (b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or
>>
>> (c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner
>
> that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, *the Court may make an order to rectify the matters complained of.* [Emphasis added.]

C. Disclosure

1. Billes' Obligation to Disclose

a. Under the USA and the *ABCA*

[308] Article 10.10 of the USA states that a conflict of interest arises where a director or an officer is a party to a material contract or a proposed material contract. Where a conflict arises the USA requires that the director or the officer disclose his or her interest, in *writing* or request to have entered in the minutes of a directors meeting the nature and extent of that interest. This manner of disclosure is from s.115 of the *ABCA* which was incorporated into the USA by reference. Further, where 50% of the directors are disqualified from voting on such a matter, it will be referred to and decided by a resolution of the shareholders. In this case Billes represented 50% of the directors of DDL.

[309] Professor B.L. Welling in *Corporate Law in Canada: The Governing Principles*, 2nd ed. (Vancouver: Butterworths, 1991), discussed the issue of what interests are "material". At 452 – 453, he stated:

> . . . it seems clear that the statute also addresses the problem of a director or officer who has no monetary interest in a person on the other side, yet who is likely to have *an emotional involvement*. Thus, a deal in which the corporation is negotiating with *a close relative*, or even a close personal friend, of one of the directors or officers ought to be suspect. ...one can assume that the courts will address their attention to the blood relation question... the only question will be to what degree of relationship the section extends. The answer is once again, subsumed under the requirement that the interest itself be “material”.
>
> What is meant by "material".... In the context of conflict of interest contracts, the meaning of "material contract" and "material interest" is conditioned by *the purpose behind the section*. The purpose is to identify those negotiations in which a corporate manager's ability to bargain effectively on behalf of the corporation may be inhibited by some interest he has in the other side. *Any personal relationship or monetary interest* he may have in the other side that might be thought to be an inhibiting factor is a material interest if disclosure of the relationship or interest might be relevant to the corporate decision whether to involve the particular manager in the negotiations. Whether to participate in a proposed contract is a corporate decision and the corporation is entitled to full disclosure from its fiduciaries of all facts that might affect that decision. This point is reflected in a 1952 judgment... [*Gray*]. [Emphasis added.]

[310] D. Peterson, in *Shareholder Remedies in Canada (supra)*, also discussed the meaning of "material". At paragraph 13.15 he wrote:

> ... the meaning of material is important in determining whether compliance with [the statute] is required where the director has an interest in some other person that is contracting with the corporation. As working rules to determine whether or not a material interest exists, it is submitted that *an assessment of control and benefit* ought to be made. If the director or officer has *the ability to cause the person in question to enter into the contract* with the corporation, the director has a "material interest" in the transaction. The conflict of interest is clear and the nature of the circumstances must be disclosed. [Emphasis added.]

[311] Given my finding that Billes exercised *de facto* control over the Trust and that her son was the beneficiary thereof, I find that Billes had a material interest in the Trust Loan despite the fact that she did not have a personal, financial interest in the Trust. Perhaps even more important,

as one of three legal entities constituting the Trust, she is "a party" to the Trust Loan under section 115(1)(a).

[312] Additionally, there is the requirement to disclose under article 10:10(a)(ii) of the USA where one is a "director, officer, or employee" of, in this case, a Lender, as Billes was a director of Newmat - see also section 115(1)(b).

[313] However, Billes argued that there is very little authority on the subject of whether a trustee who does not have a beneficial interest in the trust is subject to the requirements of section 115. Billes further argued, relying on *Dimo Holdings Ltd.* v. *H. Jager Developments Inc.* (1998), 43 B.L.R. 123 (Alta. Q.B. - Fruman J.), that:

> It is further our submission that the section was directed at a material beneficial interest or an interest in which an individual could exercise discretion or control so as to affect the financial outcome. It is a question of fact in each case.
>
> ...
>
> In this case, Billes was merely one of three trustees. She did not control the other trustees. She had no beneficial interest in the trust assets. It is submitted that her interest was not within the meaning of Section 115 of the *ABCA* or the identical provisions of the USA.

[314] As above, I have found that Billes was one of three principals constituting the Trust and exercised *de facto* control of the Trust, thereby distinguishing *Dimo*. In that case, the party who was a director of the borrower, was merely the spouse of the person who was the sole shareholder, officer and shareholder of the lender.

[315] However, even if Billes was not a principal of the Trust and even had I not found that Billes exercised *de facto* control of the Trust, the disclosure requirements would have been applicable in any event. I base this conclusion on the fact that the function of a trustee is similar to that of a director. In other words, the Trust is not a legal entity, the legal entity is the 3 individuals who were trustees of the Trust. Accordingly, it was Billes, as Trustee, who was a party to, or a party interested in, a material contract in the Trust Loan and s.115(1) of the *ABCA* and thus, the USA, required that she disclose the nature and extent of that interest *in writing*.

[316] As to the Newmat Loan, Billes, through her 100% owned corporation Marlore, owned 49% of Newmat which, although insufficient to give her control of Newmat, constitutes a monetary interest which, together with her position as a director (the latter being sufficient by itself under section 115(1)(b), constituted a "material interest". Similarly, under 10:10(a)(ii) of the USA, her being a director is sufficient to require disclosure.

[317] Billes, acknowledged in her written argument (in another context) that being a director of Newmat "placed ... Billes squarely within Section 115 ... and Art. 10.10(a)(ii)". Additionally, Billes acknowledged:

> No issue is taken that because Billes was a Newmat director, she had a legal obligation to disclose to DDL her relationship to Newmat pursuant to Section 115 of the *ABCA* insofar as the transaction concerns DDL. It is submitted that the fact that the ownership interest was indirectly held through Marlore (solely owned and controlled by Ms. Billes) is inconsequential...

[318] Accordingly, the disclosure requirements of the *ABCA* and the USA were also applicable to the Newmat Loan.

[319] There is further evidence to corroborate that Billes had a material and conflicting interest. Following the Loans, on October 9, 1992, Billes met (alone as it relates to the Lenders) with Sali, who was the Counsel representing her interests, and McAteer and Mason. This was not a meeting between DDL shareholders (although they were such - Sali calling it an "informational meeting"), but, from what I find to be its adversarial tone and content, it was in fact a meeting between DDL, represented by Mason and McAteer on the one hand, and Billes, on behalf of the Lenders, on the other. I accept the evidence of Mason that Sali advised that he was representing Billes and the Billes related entities, including the Lenders, without necessarily accepting Mason's categorization of them (especially as to Newmat) as the "Billes controlled entities".

[320] While Billes insisted that Sali was not representing the Trust or Newmat, to be clear this meeting was not called by Sali and Billes to discuss the internal operation of DDL. Rather, I find that its primary purpose was to determine, from the Lenders' perspective, how the Loans would be brought current and into good standing. In this regard, on August 10, 1992, in first referencing the retainer of Sali and a possible meeting, Billes stated (Exhibit 117) "I ask that you be prepared to address how you propose to deal with the secured creditors, particularly in the case of current defaults". She also testified, in relation to this letter:

> Sali was instructed to be dealing with McAteer about addressing how to proceed, how to deal with the secured creditors, the defaulting interest. We had agreed to accrue interest for several months. This was coming to the end of the several-month period.

[321] In his correspondence, Sali also made it clear that his interest was not just personal to Billes. In his letter to TM[24] on August 28, 1992 (Exhibit 122) he referred to "the position of the major creditors" [the Lenders] and that McAteer needed to "follow through on his convictions or face the consequences of prudent business decisions on the part of Billes and the major creditors which I advised would likely be forthcoming". I have come to this conclusion as to the purpose

[24] At this time, D'Arcy McCaffrey of TM was providing advice to McAteer on behalf of the Kingswood Group (see Exhibit 128) and was involved in communication with Sali in this regard.

of the meeting on the above evidence, notwithstanding that Sali's letter to TM on September 10, 1992 (Exhibit 125) was more neutral in tone in that he merely makes reference to his "review of matters on behalf of Billes" and requests a general meeting of shareholders in early October (Exhibit 129 sets such a meeting for October 9, 1992, and Exhibit 131 provides a proposed agenda).

[322] I find that, whether formally authorized by the Lenders or not, Billes was clearly at that meeting for the primary purpose of representing the Lenders interests. The proposal ("Basic Term Sheet")[25] prepared by Sali at the time (Exhibit 119A) corroborates this view, especially having regard to the words "all debt (principal and interest) owing to 'Martha's Group'".

[323] Additional corroborative evidence is contained in the letter (Exhibit 138), which Sali testified to as being a true and correct representation of the meeting of October 9th, written to McCaffrey on October 13, 1992, with Billes' concurrence. In that letter he wrote:

> ...there are a number of fundamental business issues which need to be addressed immediately, most notably, the manner in which existing debts and obligations are made current and dealt with in a current fashion in the future.
>
> ...
>
> ... Paul must understand that under no circumstances are Martha or the secured creditors to be taken as having agreed to do so [grant extensions on Loan and interest payments] or having waived any rights to which they are otherwise entitled. This brings me to the point at which the discussions terminated, by me advising Paul that it appeared that we did not have anything more to talk about.
>
> ... there is a substantial amount of secured debt owing to "Billes related" parties, namely Newmat Drilling, the Billes Estate, and the Trust....

Only later in his letter did he refer to the possibility of the secured creditors retaining independent legal advice to realize their security. This indicates clearly that at the time of the letter and, therefore, the October 9th meeting, Sali was representing not only "Martha", but also the "secured creditors" or "Billes related parties". Certainly this was the interpretation of Mr.Trawick (then Counsel to Mason) when he responded to Desbarats on November 18, 1992 (Exhibit 158).

[324] Sali also noted that "there is a substantial amount of secured debt owing to "Billes related" parties, namely Newmat ... and the Trust". He further confirmed in testimony that when McAteer requested an extension of time for payment, he responded at the meeting with words to the effect:

[25] McAteer rejected a proposed shotgun buy-sell in favour of a buy out by him or an asset split (Exhibits 128 and 135).

> ... certainly if you want any kind of an extension of time you would have to provide some kind of an acknowledgment that there would be no challenge to the loan arrangements or security or nor would you be contending things such as other relationships or the like.
>
> ... So I raised that as a proposal to McAteer and Mason. McAteer responded by saying he wouldn't. And quite frankly, that was a bit of a surprise to me. But having regard to his response, my reaction was, well, if that's the case I don't think we have much to talk about. And shortly thereafter, the meeting closed.

[325] Billes' conflict of interest between DDL, the Trust and Newmat is recognized in the letter of response of Mr. Shortt, then Counsel to DDL (forced to cease acting on November 30, 1992 (Exhibit 174) due to the receivership), when he responded to the demand on the Loans on November 25, 1992 to Pitblado (Exhibit 172):

> It is shocking to us that a director of DDL [Billes] whose fiduciary and statutory duties require her to act in the best interests of DDL would elect to put "her security" first to the prejudice of DDL, its shareholders, creditors and partners...

[326] Despite the application of the conflict and the applicability of the disclosure requirements, Billes argued, that her interest was:

> ... not required to be disclosed again in October, 1991, when McAteer was aware of the nature and role of Marlore as a result of the financial disclosure which Billes had made to him pursuant to the terms of Exhibit 21[the Domestic Agreement].

[327] Without getting into the precise timing of McAteer's knowledge of Billes' interest in Newmat (discussed *supra*), much of the "damage" (I use the word in a literal, not legal sense here) was done as a result of the failure of Billes to disclose and get the consent of Mason on the Trust Loan. Therefore, the failure to do likewise with the Newmat Loan is really a matter of "over-kill". The failure is the same, the breach of the statute and the USA the same, and the cause of action the same. All that is different is the measure of damages (here, in a legal sense). In the result, I find that Mason is entitled to the same declaration and judgment under the oppression remedy for Billes' breach of the USA and statute as to both the Trust and Newmat Loans, but is only entitled to one set of damages, namely the value of her shares at the time of the first infringing transaction which is also when they were at their highest value, namely, at the time of the Trust Loan.

b. At Common Law

[328] The general rule of equity is that anyone who has a duty of a fiduciary nature to perform is prohibited from entering into engagements in which he or she has or can have a personal interest conflicting with the interest of those who he or she is bound to protect.

[329] Mason referenced D. Peterson, in *Shareholder Remedies in Canada* (*supra*), who summarized the common law on interested transactions at para. 13.1 as follows:

> ...The common law on interested transactions has been summarized as follows:
>
>> To prevent abuse of directors' fiduciary position, the courts developed a strict rule that contracts of a corporation in which one of its directors had a personal interest, whether pecuniary or non-pecuniary, were voidable at the option of the corporation (*North West Transportation Co. v. Beatty* (1887), 12 App. Cas. 589 (J.C.P.C.); *Aberdeen Railway v. Blaikie* (1854), 2 Eq. Rep. 1281) and that the interested director was liable to account for any profits received (*Transvaal Lands Co. v. New Belgium (Transvaal) Land & Development Co.*, [1914] 2 Ch. 488 (C.A.)). The strict common law rule could be avoided only if the company's constitution permitted such contracts (*Imperial Mercantile Credit Assoc. v. Coleman* (1871), L.R. 6 Ch. App. 558 at p. 567, revd on other grounds (1873), L.R. 6 H.L. 189; *Roray v. Howe Sound* (1915), 22 D.L.R.. 855 (B.C.C.A.); and *Huggard v. Prudential Life Ins. Co.*, [1924] 1 W.W.R. 642 (Man. C.A.)) or if the shareholders ratified the contract (*A.-G. Can. v. Standard Trust Co. of New York*, [1911] A.C. 498 (P.C.); *Northwest Transportation Co. v. Beatty*, supra, footnote [313]). [Emphasis added by Mason.]

In addition to the above, Billes cites *Bamford* v. *Bamford*, [1969] 1 All E.R. 969 (C.A.) as further authority for the proposition that a voidable contract may be ratified by the shareholders.

[330] Mason, relied on M.V. Ellis, *Corporate & Commercial Fiduciary Duties* (Scarborough: Carswell, 1995), at 15-5, which cited Kellock J. in *Zwicker* v. *Stanbury*, [1953] 2 S.C.R. 438 where at 440 he adopted the words of Viscount Sankey in *Regal (Hastings) Ltd.* v. *Gulliver*, [1942] 1 All E.R. 378 at 381 (H.L.) as follows:

> ... the general rule of equity is that no one who has duties of a fiduciary nature to perform is allowed to enter into engagements in which he has or can have a personal interest conflicting with the interest of those who he is bound to protect.

Later at 15-22 Ellis stated:

> The law countenances, to a very limited degree, a director's gain through conflict of interest only where: 1. the director fully discloses the conflict...

[331] At common law, Billes, as a director and 50% shareholder of DDL, was required to fully and fairly disclose her interest in the Lenders. However, as disclosure was required by both contract through the USA, and statute, little reliance need be placed on the common law.

2. Actual Disclosure Provided

[332] As set out at section 115(7) a material contract transaction may stand so long as: (1) the director or officer provided adequate disclosure; (2) the contract was approved by the directors or shareholders; and (3) it was fair and reasonable to the corporation at the time it was approved. What follows is a consideration of those factors.

[333] There is no evidence to indicate that Billes disclosed her interest in writing as required by the USA and the *ABCA*. Unlike the USA and the *ABCA*, there is no requirement at common law that disclosure be in writing. In any event, I find as a fact that Billes' interest was not disclosed orally or in writing to Mason by Billes, McAteer or anyone else.

[334] The evidence disclosed that Billes orally informed McAteer that she was a Trustee in relation to the Trust and that he knew that she had *de facto* control of the Trust. McAteer knew she was a director and shareholder (through Marlore) of Newmat. McAteer was also provided with written disclosure in relation to Billes' interest in Newmat as a result of the Domestic Agreement.

3. Effect of Oral Disclosure to McAteer

[335] I have found that all of Billes' interests in the Trust and Newmat were disclosed to, and/or learned by, McAteer, meeting the disclosure requirements at common law.

[336] As set out above, I accept Billes' evidence that McAteer undertook to advise Mason of Billes' interest in the Lenders and to obtain Mason's consent to the Loans in a manner that would satisfy the disclosure requirements. Had he done so by recording Billes' interests in the directors minutes or otherwise in writing, that would have been valid notice to him, and through him, to DDL. However, it would not have been sufficient in relation to Mason without having been brought to her attention. None of this happened.

[337] I find that oral disclosure by Billes to McAteer, without more, is not notice to DDL, and, most importantly, certainly not notice to Mason as required under the USA and the *ABCA.*

[338] Billes also argued, specifically in response to issues relating to the Newmat Loan, but equally applicable to the Trust Loan, that:

> . . . Billes disclosed to McAteer her interest in Newmat.
>
> Although Billes did not disclose in writing, she asked and reasonably expected that McAteer see to the appropriate resolution of the issue. Billes therefore satisfied the second branch of section 115(1) of the *ABCA*.

[339] The "second branch" of section 115(1), of course, relates to the interested party's "... request to have entered in the minutes of meetings of directors the nature and extent of his

interest...”. Thus, the argument goes, that by requesting McAteer to do so, and obtaining his undertaking in that regard, and his later representation that he had done so, Billes ought to be exonerated. Nevertheless, later in the same argument Billes equivocates with respect to the specificity of such a request:

> ... Whether or not Billes specifically requested that her interest be entered in the minutes, as opposed to merely advising McAteer (the lawyer) of her interest, is inconsequential.

[340] As noted *supra*, I do not find any basis for liability against McAteer as a lawyer. Therefore any liability flowing to McAteer must be based on some other duty.

[341] Billes submitted further that she discharged her obligation to disclose by leaving the matter in McAteer’s hands. She stated that at the time she made the request of McAteer she believed him to be a trusted corporate officer and had no reason to believe that he would not fulfill her request. She argued that she was entitled to rely on McAteer in that regard and having done so she was absolved of any liability *vis-a-vis* Mason. In that regard, she relied on *Blair* v. *Consolidated Enfield Corp.*, [1995] 4 S.C.R. 5, where at paragraph 69, Iacobucci J, writing for the Court, stated:

> I should also mention that section 135(4) codifies the anterior common law director duties of care, in which a director would be absolved of liability if he or she relied upon the work of an official of the company (in the present appeal, corporate counsel) if such work is properly left to that official and, in the absence of grounds for suspicion, the director is justified in trusting that official to perform the duty: *Re City Equitable Fire Insurance Co.*, [1925] Ch. 407, per Romer J., aff’d [1925] Ch. 500 (C.A.). Consequently, the director will be held liable for the misdeeds of officials of the company only if they have been personally negligent or if they have acted unreasonably in relying on an official whose honesty or competence they have reason to suspect.

[342] *City Equitable Fire Insurance*, was a negligence action. It held, *inter alia*, that:

> In respect of all duties that, having regard to the exigencies of business, and the articles of association, may properly be left to some other official, a director is, in the absence of grounds for suspicion, justified in trusting that official to perform such duties honestly.

[343] In my view Billes’ actions were reasonable in the sense that she had no reason to doubt McAteer’s honesty and competence at the time she made her request of him. However, even though McAteer undertook the task and represented he had accomplished it, Billes cannot avoid liability to Mason in the present circumstances.

[344] I find in this case that McAteer, while indeed an officer and director of DDL, had not undertaken the task *qua* officer or director of DDL. He had no obligation *vis-à-vis* Billes or DDL to do so in those capacities, nor did he do so in such capacities. I find he did so merely in a personal capacity, having regard to the personal relationship between him, Billes and Mason. This is clearly distinguishable from *Blair* where the Court found (headnote and paras. 39-42) that Blair was involved in his capacity as a director/chairman of the corporation, not in his personal capacity. Therefore, these authorities do not assist Billes.

[345] Where the authorities are applicable to a duty undertaken *qua* company official (not here), in my view the proposition that a director will have satisfied his or her duty of care and fiduciary duties by relying on what appear to be trusted company officials is eminently reasonable. It simply would not be viable for a director to perform all of the duties associated with a corporation. Nor, would it be feasible to require a director to follow up and ensure that every duty delegated was properly and adequately performed. Simply put, delegation is demanded by the exigencies of business, particularly in large and complex corporations. That proposition does not, however, allow a director to avoid his or her statutory duties under section 115 *ABCA* nor does it apply to the liability of shareholders who are party to a USA.

[346] In the present case, the USA incorporated the disclosure provisions of the *ABCA* and adds further requirements. Thus, the parties have contractual duties to one another. In my view there is nothing in *Blair* or *City Equitable Fire* that relieves a party of its contractual obligations under a USA.

[347] Further, a USA, by its nature, confirms and/or augments the rights, powers, and duties of directors and makes them applicable, as a matter of contract, to shareholders as parties to the USA. At the same time, the parties to the USA incur all of the associated liabilities. Thus, Billes' failure to disclose exposes her to liability *vis-a-vis* Mason not only as a director but also under the USA in Billes' capacity as a shareholder.

[348] Accordingly, Billes was under both a statutory and a contractual duty to fulfill the disclosure requirements as a director and shareholder. There is nothing in either *Blair* or *City Equitable Fire* that would absolve Billes of her statutory duty set out at section 115, or of her contractual liability, to Mason.

4. Conclusion on Disclosure

[349] In conclusion, I find that Billes, in her capacities as principal of the Trust, as *de facto* controlling Trustee to the Trust, and as a 49% shareholder and director of Newmat, had a material interest in the Loans. While it is trite to say so, I find further that the Loans were material contracts, having an impact on the value of DDL. As such, Billes was in a conflict situation *vis-à-vis* DDL, and had a duty to disclose her interest in writing under the USA and the *ABCA*. No written disclosure was made by Billes to Mason. Accordingly, Billes failed to fulfill the first requirement under section 115(7) of the *ABCA*.

D. Shareholder Approval

[350] By reason of her conflict, pursuant to the provisions of section 10.10(a) of the USA, Billes was precluded from voting on any resolution to approve the Loans. Since Billes could not vote on any such directors’ resolutions, the unanimous consent of the board of directors could not be obtained under section 9.02 of the USA. Accordingly, by section 10.10(c) of the USA, the matter had to be referred to and decided by the shareholders. The evidence in this case establishes that there was no such referral and no shareholders’ resolution was obtained. Accordingly, *prima facie*, the second prerequisite set forth in section 115(7) of the *ABCA* (approval by shareholders) was not met.

[351] Billes argued on several occasions that there was shareholder approval to the Loans - specifically:

> In any event, if shareholder approval was required under Article 9, it was provided through the shareholders' agreement that the loan would be made. Further, it is submitted that there was shareholder approval with respect to the particular loan, which satisfied the requirements of Article 10.10.
>
> Shareholders' meetings need not be formal, nor called with notice. If the shareholders are present and agree to deal with shareholders' matters, there is a shareholders' meeting.
>
> *Eisenberg (formerly Walton)* v. *Bank of Nova Scotia and Ridout*, [1965] S.C.R. 681

I do not challenge the accuracy of the above authority. However, I find that there was never any meeting of shareholders called, nor any shareholders resolution passed, nor did Mason, as a 40% shareholder, ever approve the transactions.

[352] There is another aspect of approval to consider. The USA provided (in article 9.02, *supra*) that there could be no borrowing in excess of $500,000 in the aggregate without the unanimous approval of the directors. While McAteer and Billes purported to approve the Loans, there is no specific mention in the certified directors’ resolution for the Trust Loan (Exhibits 36 and 37) or the Newmat Loan (Exhibits 76 and 306) of approval of the aggregate of loans over $500,000. It was argued that not only was there no approval of the Loans by the shareholders as required, but, in that Billes was disqualified as a director from approving the Loans, there was a requirement of shareholder approval under article 9.02 as well. There was no shareholder approval of either.

[353] Billes argued that article 9.02(i) was inapplicable. In that regard, she referred to the Consolidated Pro Forma Balance Sheet (Exhibit 15) in that, in addition to the shareholders loans of $381,079, once the first McLarty loan in the amount of $400,000 was made in June, 1990, or the Directors resolved to issue debt to the Murrays for $375,000 on July 3, 1990 (Exhibit 303), DDL became indebted in an aggregate amount exceeding $500,000. Thus, Billes contended that

there was no requirement in the USA for further consent when the additional Loan debt was incurred.

[354] I do not accept that argument. In my view the purpose of the provision was, on any specific proposed transaction, to have the directors apprised of and to give consideration to the aggregate amounts of loans made. I believe that this is implied in the phrase “outstanding at any one time”, the time being each time the aggregate was increased above $500,000. As such, I find that unanimous consent of the directors was required. However, I agree with the substance of Billes’ argument that, if such approval was necessary:

> Billes was competent, whether or not she had a material interest in a proposed lender, to provide any additional consent required under Article 9.02. The decision to permit the company to become indebted beyond $500,000 is a matter which is distinct from the approval of any particular loan, and as such is not a matter within Article 10.10(c).

[355] Such could be accomplished by a directors’ resolution noting the approval of the Loan by the shareholders, and then providing approval of the aggregate under article 9.02. It follows that I do not agree with Mason that an approval under article 9.02 was required by the shareholders in the circumstances or that Billes could not have approved a properly worded directors’ resolution for DDL to borrow over $500,000. However, I agree with the implied argument that Billes could not approve of such an aggregate only by approving a specific Loan in which she had an interest. In any event, there was no directors resolution to increase the aggregate amount of debt, and because Billes was not legally capable of approving the Loans, a purported approval of the Loans could not be substituted for approval under article 9.02.

[356] In conclusion, I find that there was no approval of the Loans, including the specific transactions or the aggregate, and therefore the requirement of the second branch of section 115(7) was not satisfied.

E. Reasonable and Fair Contract

[357] The third requirement under section 115(7) is that the transaction was reasonable and fair to the corporation at the time of approval. I find that, as between DDL and the Lenders, the Lenders’ Loans were reasonable and fair to DDL at the time of approval. I find that they were also reasonable and fair internally within DDL, except for the non-disclosure to and non-approval by Mason, and except for the additional $200,000 Loan under the Newmat Loan.

[358] Mason relied on D. Peterson, *Shareholder Remedies in Canada*, as to the issue of reasonableness and fairness, including the following references in paras. 13.29 and 13.31:

> 13.29 To avoid having a material interest contract set aside, it must be "reasonable and fair to the corporation at the time it was approved. ... Of course, what is "reasonable and fair" depends on the circumstances of each case. Under

> the CBCA-type legislation, the fairness and reasonableness of the interested transaction is with respect to the corporation only. In *Rooney* v. *Cree Lake Resources Corp.* (1998), 70 O.T.C. 241 (Gen. Div.), Dilks J. commented as follows:
>
> > In determining whether a particular contract is reasonable and fair to the corporation, one must examine all the surrounding circumstances including the purpose of the agreement and its possible ramifications for the corporation. It need not be either fair or reasonable to the director. It is his fiduciary duty to the corporation which requires it to be reasonable and fair to the corporation.
>
> What is reasonable and fair changes over time as well, but the provisions limit the time frame to the time at which the interested transaction is approved.

…

> 13.31 A question may arise as to the best way to avoid an interested contract from being attacked on the grounds of reasonableness and fairness. In *Summa Corp.* v. *Trans World Airlines Inc.* [(1988), 540 A. (2d) 403 (Del. Supr.)], the test for a reasonable or fair contract was stated to be a "transaction that would have recommended itself to an independent board of directors that was acting in good faith and had the best interests of the corporation in mind." It would seem, therefore, that the presence of a sound, independent board is the best precaution when approving interested contracts. [Emphasis added by Mason.]

[359] McAteer argued “We anticipate the Billes defendants will argue the loans were reasonable and fair on their terms. While we advance no argument, we do not agree”, and went on to argue that the issue was the validity of the Loans, not their reasonableness and fairness. It is not surprising that McAteer did not challenge the reasonableness and fairness of the Loans, as it was in general, if not completely, his proposals which were accepted by the Lenders.

[360] Moreover, the terms of the Newmat Loan (*inter alia*, Exhibit 324) were more favourable than those proposed by Household Trust (Exhibit 307) (being considered at the time of the Newmat Loan) and it appeared that no other lenders were willing to lend funds. McAteer himself acknowledged in cross that, after he considered “all the options”, “it was a reasonable option under the circumstances” for DDL to enter into the Newmat loan.

[361] In support of reasonableness and fairness Billes argued, *inter alia*, that Cristall's evidence was that the terms of the Loans were reasonable and fair, and indeed very favourable to the borrower. She also pointed out that the Plaintiffs did not adduce any expert evidence to the contrary.

[362] BJ said this about the reasonableness and fairness of the Trust Loan, as it relates to DDL:

> ... the Trust Loan was shown to be in the best interest of DDL and was made on reasonable terms. Indeed, the evidence is that the interest charged on the Trust Loan was less than that being charged by DDLW to Kingswood on the Mortgage which was ultimately foreclosed. On the totality of the evidence, there can be no suggestion that the Trust Loan was other than fair and reasonable and necessary to DDL. There is no equitable or fairness imperative to set it aside.

[363] I agree, but add that the result is also the same for both Loans - their terms were reasonable and fair to DDL at the time it was executed, subject to three considerations.

1. 5% Bonus

[364] Mason argued:

> ... that the Trust loan was not reasonable and fair to DDL. In particular, the provision which provided for a forfeiture of a 5% interest in the Golf Club Partnership on default [see Exhibit 37[26]] is unfair to DDL.

[365] As to the issue of the 5% bonus transfer of Club LP partnership units on default of the Trust Loan, which received very little consideration during the trial, there are three issues: who proposed it; is it unreasonable and/or unfair; and what are the consequences if it was unreasonable and/or unfair.

[366] McAteer said he found the 5% bonus transfer of Club LP partnership units "offensive" and claimed it was unenforceable as a "penalty" (see Exhibit 149, dated November 16, 1992). Yet, he drafted the Draft Commitment Letter for the Loan (Exhibit 29 and Exhibit 361) in which this provision was contained and he approved the Loan with the provision therein. He said the provision was contained in the Draft "as a result of negotiations with Michael Lavery on behalf of the Trust and lender", and that there were no further negotiations available on this point.

[367] Billes argued McAteer proposed the term. She argued that her and Lavery's evidence established that "Exhibit 361 was the first proposal provided by McAteer to Billes on February 14, 1991 and that McAteer initially proposed the penalty on default", which she then discussed with Lavery on February 15th.

[368] Billes did not defend the substance of the provision, but merely argued:

[26] See also Exhibit 29, last clause of the February 11, 1991 Draft Commitment Letter from the Trust to DDL.

> If the forfeiture provision in the Trust loan is found not to be fair or reasonable, then the same can be severed, and in any event the same had no bearing upon the events in question, and bore no relationship to DDL's inability to repay or to the enforcement of the security.

I agree.

[369] No independent expert was called to testify that the provision was unreasonable, and Cristall, without addressing the provision itself, provided evidence in a broad sense that the terms of the Loans were reasonable and fair. Therefore, on the uncontradicted evidence one would have to conclude that this term was reasonable and fair. However, even if it were not reasonable and fair, it would not make a difference, because, as Billes argued, it is severable. Even more importantly, no one on behalf of the Trust is trying to enforce the provision in these proceedings nor have they on the evidence done so outside the proceeding and, accordingly, nothing of substance turns on it.

2. $200,000 Loan

[370] Mason argued that the $200,000.00 Loan advanced to reduce McAteer's shareholder's loan and to provide funds to resolve issues between him and Billes, was unfair and unreasonable to DDL.

[371] This argument is accurate in one sense, but is "turned on its head" in another. Internally within DDL, was it reasonable and fair for DDL to be borrowing for this reason, at the request of McAteer and Billes? The answer is a resounding "No", but that will be dealt with in the Derivative Action. The relevant question in this context, however, is whether it was reasonable and fair for Newmat to loan funds, that were otherwise on reasonable and fair terms, to DDL for this (or any other) purpose, which purpose was in the sole control of the borrower and its officers? The legal answer is "Yes". *Vis-à-vis* the Lender and the borrower the "reasonableness and fairness" relates to the terms of the Loan, not the purpose for which the funds were sought. What right did Newmat have to challenge DDL's purpose of the Loan?

3. Reasonableness and Earnings to Mason

[372] On another point, BJ also argued:

> Mason and her children were not wronged or injured in any way by the Trust Loan. To the contrary, it was in their interest because without it the value of their shares in DDL was jeopardized from lack of capital to pursue the business plan.

[373] BJ may be correct that Mason and her children were not injured by the granting of Trust Loan. However, they were injured by the enforcement of the security for it on default. More to the point, they were wronged by not having an opportunity (given to them by the USA, by the

ABCA and the common law) to determine whether or not they wished to be involved in the risk which ultimately manifested in the default of the Loan and the loss of their entire investment. It was the lack of respect for their rights that was the wrong. It was the realization of the risk that was the injury. The value of their shares was not in jeopardy prior to the Loan, which is the time that they had the right to assess the risk.

4. Conclusion

[374] On considering the evidence and arguments, I have concluded that the terms of the Loans were reasonable and fair, as between the Lenders and DDL. Accordingly, the third requirement of section 115(7) was met.

F. Conclusion on Compliance with Section 115(7)

[375] The Loans are not void or voidable if all three components of section 115(7) are met. I have found that the first two components were not met, although the third one was.

G. Validity of the Loans

[376] Failure to satisfy the terms of section 115(7) of the *ABCA* permits the Court, under section 115(8), to exercise its discretion to set aside the transaction on any terms it thinks fit.

[377] However, before ever considering section 115(8), Billes *et al.* argue, in effect, that the Loans cannot be set aside where there is lack of knowledge of the breach of section 115(7) by the Lenders.

1. Loans Valid Due to Lenders Lack of Knowledge of Breach

[378] Billes *et al.* argued, relying upon *Dimo, Beck* v. *Graham*, [1991] O.J. No. 208 (H.C.), online: QL (OJ)*; Liu* v. *Sung* (1997), 37 B.C.L.R. (3d) 158 (C.A.); *PII Photovision International, Inc*. v. *Thayer* (1996), 30 B.L.R. (2d) 286 (B.C.S.C.), and *Cannaday* v. *McPherson* (1995), 25 B.L.R. (2d) 75 (B.C.S.C.), rev'd (1998), 44 B.C.L.R. (3d) 195 (C.A.), that lack of compliance with section 115 of the *ABCA* does not render the transaction void, but merely voidable. Billes argued further:

> Even if shareholder approval were absent this would not affect the validity of the loan. Non-compliance with articles, by-laws or any unanimous shareholders agreement may not be asserted against a person dealing with the corporation unless the person has, or by virtue of his or her position with or relationship to the corporation ought to have, knowledge of those facts at the relevant time.
>
> *ABCA*, sections 15, 16, 17 and 18.

I agree.

[379] As to the facts relevant to this argument, Billes *et al*. submitted, in part[27]:

> The Trust is not a "person" who has, or by virtue of its position with or relationship to DDL ought to have, knowledge of any alleged non-compliance at the relevant time. Neither Mann nor Lavery have been shown to have any knowledge of non-compliance. Billes' evidence is that McAteer assured her that he would seek the consent of Mason and ensure the matter was properly minuted, and that he represented to her that he had done so. McAteer was a lawyer, the President and Secretary of the company.... He had custody of the Minute Book. It was not unreasonable for him to undertake that role or for Billes to expect that he would carry it out. He formally represented in the Officer's Certificate that the USA did not impede the loan. Thus, Billes is not a person who had, or by virtue of her position with a relationship to DDL ought to have had, knowledge of any alleged non-compliance.

The same arguments apply, *mutatis mutandis*, to Newmat, and Newel, Steven Matkaluk (“Matkaluk”) (26% shareholder in Newmat) and Billes in this context. I have found that the Lenders (including Billes in that capacity) may rely on that provision in relation to the breach of the USA. See also my analysis on this issue of knowledge by the Lenders under “Constructive Trust”, *infra*.

[380] No party challenged Billes’ statement of principle, but McAteer challenged the facts. McAteer agreed with the indoor management rule, and the effect of lack of knowledge in law, but argued that there was knowledge in fact:

> The debenture is void and unenforceable against DDL by the Trust. Following both *Rolled Steel Products (Holdings) Ltd.* v. *British Steel Corporation and others,* [[1985] 3 All E.R. 52 (C.A.)] and *Anderson Lumber Co. v. Canadian Conifer Ltd.* [(1976), 66 D.L.R. (3d) 553 (Alta. S.C. (T.D.)), aff’d (1977), 4 A.R. 282 (C.A.), leave to appeal refused (1978), 7 A.R. 88 (S.C.C.)] when a contract is entered into by the directors in excess or abuse of its power, or in noncompliance with its articles a third party, without knowledge of the excess or abuse of its power, may rely on the act of the directors as valid, “the indoor management rule.” **If, however, the third party has actual or constructive notice that such steps had not been taken, he will not be able to rely on any ostensible authority of the directors and their acts, being in excess of their actual authority, will not be the acts of the company.**
>
> In the case at bar, Billes has failed to disclose her interest in the Trust in writing as required by the USA and the *ABCA.* Billes also failed to fully inform McAteer of her true involvement with the Trust. The matter, entering into the

[27] I have excerpted certain provisions of this quote with which I do not agree.

> loan agreement with the Trust, was not referred to the shareholders of DDL as required pursuant to the USA. The board of directors acted in excess or abuse of its power and the Trust had knowledge, actual, through Billes, of that excess or abuse of power. The Trust can not invoke the rule in *Royal British Bank v. Turquand*, [1843-60] All E.R. Rep. 435 (Ex. Ct.) "the indoor management rule" because the creditor (Trust) was represented by a trustee (Billes) who was also a shareholder/director of the debtor [DDL]. Billes's knowledge became the creditor's (Trust's) knowledge. In other words the creditor knew of the irregularities of debtor and could not rely on the lack of knowledge of the irregularity to permit it to enforce the debenture based on the indoor management rule. [Emphasis in the original]

[381] As is obvious from my findings in these Reasons, I do not agree with most of this argument. Specifically, I have found that: Billes fully disclosed her interest to McAteer, and accepted his undertaking that he would and had done all the things necessary to disclose her interest and obtain shareholder approval; and that Billes had no knowledge of McAteer's failure to carry out his undertaking. Indeed, I find that all the things McAteer claimed Billes failed to do were things which, in fact, I find he undertook and failed to do. Moreover, Billes did not have knowledge that the steps required to validate the Loans had not been accomplished. Accordingly, that knowledge could not be imputed to the Lenders through Billes and the Lenders are protected by the indoor management rule.

[382] Therefore, on this basis, I find that the Loans are not voidable.

2. Remedy under Section 115(8)

[383] Billes also argued in relation to the statutory breach that the Court has a discretion as to whether to grant a remedy under section 115(8), namely, to set aside a transaction for lack of compliance with section 115. I agree: *Dimo Holdings, supra*, at 128-129; *Beck, supra*; and *PII Photovision (supra)*. I agree. Further, Billes relied on the comments of Fruman J. (as she then was) in *Dimo* at 129, that "if the transaction cannot be unwound, it should not be unwound", and that is particularly so where the debtor received the loan funds and cannot repay.

[384] As noted elsewhere in these Reasons, Mason acknowledged that it would be difficult to "unscramble the egg" and argued that a remedy under the oppression provisions of the *ABCA* would be appropriate, as an alternative to setting aside the Loans.

[385] In my view it would be inappropriate for the Court to exercise its discretion under section 115(8) to set aside the Loans in this case for a host of reasons, including, but not limited to:

(a) the Loans were, in my view, reasonable and fair to DDL at the time of their approval[28], a consideration which Billes, correctly in my view, argued was relevant to the section 115(8) discretion;
(b) they were necessary for DDL to continue its plans, especially the Newmat Loan as it appeared that DDL was not able to find adequate financing elsewhere;
(c) while it was ultimately Billes' responsibility to disclose her conflict of interest to Mason under the USA and section 115 of the *ABCA*, her failure to do so was largely due to McAteer's failure to carry out his undertaking to her and his representation that he had completed it;
(d) the only party injured as a result of the non-disclosure and non-approval, other than the $200,000 Loan (to be discussed further in the Derivative Action), is Mason, and she has a full remedy under the oppression provisions of s.234 of the *ABCA*;
(e) the Loans cannot be completely unwound - the Court should not unwind only a portion of the transaction - it is not possible to "unscramble the egg";
(f) the Loans were granted for valuable consideration and the funds from the Loans were further advanced to, *inter alia*, the Kingswood Entities and used for construction projects, including the construction of the KG&CC and the Golf Dome. Furthermore, those entities and DDL were unable to repay the funds advanced. In other words, DDL was unable to effect *restitutio in integram* (restore the parties to their previous positions): *Delorme v. Metcalfe Realty Co. Ltd.*, [1968] 1 O.R. 124 at para. 2 (H.C.J. - Haines J.); *Liu* at para. 7 and *Cannaday* v. *McPherson, supra*;
(g) related to (e) and (f), legitimate third party rights have now intervened: *Liu* at para. 5b; and *Bull HN Information Systems Ltd.* v. *L.I. Business Solutions Inc.* (1994), 161 A.R. 268 at para.25 (Q.B. - Kent J.);
(h) realization has taken place on the "hard" assets held as security and there is no value to the limited partnership units which were also held as security;
(i) the validity of the construction mortgage is, or may be, *res judicata* by virtue of the Manitoba foreclosure;
(j) perhaps most importantly, the Lenders were unaware of the non-compliance of the Loans, and, indeed, received and relied on Officer's Certificates that there was compliance; and
(k) not without relevance, it would indirectly give a remedy to McAteer that he does not deserve. I say this because, not only do I find that he had actual knowledge of Billes' conflict and the details of her interest, he specifically approved the Loans. Therefore, *vis-à-vis* McAteer, there was substantial compliance with all of section 115, except the requirement of writing, and that failure I find rests at his feet based on his undertaking to Billes.

[386] Accordingly, I exercise my discretion not to set aside the Loans under s.115(8) of the *ABCA*. Therefore, it follows that the Trust and Newmat Loans are not void or voided, but rather

[28] This is to be distinguished from the interests of the individual shareholders of DDL, as was discussed *supra*.

valid. Accordingly, there is no need to consider the arguments relative to the distinctions between remedies as they relate to the different security provided.

F. Other Available Remedies

[387] The determination that a remedy is not appropriate under section 115(8) does not, however, dispose of the issue of Billes' liability for failure to provide disclosure in accordance with the USA and the *ABCA*. All of this was at the expense of Mason, who, in the process suffered a breach of her rights as a shareholder under the USA. Billes' liability to Mason in this regard is not in her role as a Lender, but in her role as a signatory to the USA. That breach is entitled to a remedy. The next issue is the appropriate remedy.

[388] There are remedies that are available to compensate those whose rights and interests have been breached. In my view those rights and interests are only those of Mason and, to the extent of the $200,000 Loan, DDL. In my view these rights are best remedied through the oppression remedy, and, if available, the Derivative Action respectively.

1. The Oppression Remedy

[389] The oppression remedy under the *ABCA* is set out at s. 234, quoted *supra*.

[390] The broad nature of the oppression remedy has been acknowledged by both courts and academics. In that regard, Mason cited D. Peterson, *Shareholder Remedies in Canada*, at para. 13.42:

> 13.42 Where there has been a breach of the interested transaction provisions, some thought should be given as to the most appropriate remedy for relief. ... Orders setting aside contracts and accounting for profits have been made under the oppression remedy. There is a greater body of jurisprudence under the oppression remedy on which one may rely, and to the extent that the issue is the reasonableness and fairness of the transaction or there is other questionable conduct involved, it may be most expeditious to settle all matters under the oppression remedy. However, for an isolated case of breach of the interested contract provisions, it may be more convenient to proceed under those provisions for relief, particularly where the breach is simply a matter of a failure to disclose the interested contract or obtain the prescribed shareholder or director approval. [Emphasis added by Mason.]

[391] Similarly, McDonald J. in *First Edmonton Place* v. *315888 Alberta Ltd.*(1988), 60 Alta. L.R. (2d) 122, at 136 (Q.B.), stated:

> This remedy, as it appears in s. 234 of the *CBCA* (and now in s. 234 of the A.B.C.A.) has been described as "the broadest, most comprehensive and most open-ended shareholder remedy in the common law world" (Stanley M. Beck,

> "Minority Shareholders' Rights in the 1980's", in Law Society of Upper Canada Special Lectures (1982) Corporate Law in the 80s, 311 at p. 312). It gives the court wide discretion to remedy virtually any corporate conduct that is unfair.

[392] Accordingly, Mason argued:

> It is respectfully submitted that in the circumstances of this case, from Mason's perspective it would be appropriate to rectify all matters under the oppression remedy. Billes, McAteer and the lenders of the Trust loan and the Newmat loan ought to be directed jointly and severally to compensate Mason in an amount equal to the loss in the value of the shares of Devoncroft caused by the oppressive conduct.

Aside from the reference to Lenders liability, I agree.

[393] I agree further that the oppression remedy is, in the circumstances, the most appropriate avenue by which to provide Mason a remedy for McAteer's and Billes' conduct. In arriving at that conclusion I have, considered the policy underlying the remedy. I have also had regard to the development, purpose and application of the oppression remedy to date.

a. History and Purpose of the Remedy

[394] The history of the oppression remedy and the policies underlying it are thoroughly canvassed in *First Edmonton* (Q.B.). Although the Court of Appeal ultimately stayed the order granted by the trial judge in that decision ((1989), 71 Alta. L.R. (2d) 61), the discussion remains instructive in the context of the development of the remedy.

[395] Prior to the creation of the statutory oppression remedy, the courts accepted that business decisions were to be made by directors and majority shareholders. In other words, the courts accepted the "majority rule" principle and left the decision to sue in the hands of those who controlled the corporation. Accordingly, the courts only involved themselves with the internal management of corporations in very limited circumstances.

[396] The courts were later granted limited power to deal with acts of oppression by statute. By s. 210 of the *Companies Act, 1948* (U.K.), 1948, c. 38, the courts were given a narrow power to remedy oppressive conduct. In order to obtain an oppression remedy under those provisions the applicant had to first show that a winding up order was justified and then persuade the court that an order of that nature would be unfair. Further, an isolated act was insufficient to invoke the remedy. Rather, a continuous course of oppressive conduct was required. The landmark case in relation to those provisions is *Ebrahimi* v. *Westbourne Galleries Ltd. and others,* [1972] 2 All E.R. 492 (H.L.).

[397] Later legislation, namely, the United Kingdom *Companies Act, 1980* (U.K.), 1980, c.22 and *The Companies Act, 1985* (U.K.), 1985, c.6, further expanded the remedy such that it

became available on the basis of conduct which was “unfairly prejudicial to the interests of some part of the members” (*First Edmonton* (Q.B.), at 136-138).

[398] The first Canadian jurisdiction to enact oppression legislation was British Columbia, in 1960. However, the oppression remedy was not generally available in Canada until the *Canadian Business Corporations Act*, S.C., 1974-75-76, c.33, was proclaimed in force December 15, 1975. Shortly thereafter, a number of provinces, including Alberta, adopted very similar provisions. Indeed, the *ABCA* is modelled after the *CBCA*. Accordingly, the policies underlying the *CBCA* oppression remedy are of assistance in interpreting the analogous provisions of the Alberta statute[29].

b. The Scope of the Oppression Remedy

[399] Prior to the enactment of the *CBCA*, a task force was established by the Federal Government to consider the appropriate role and scope of the legislation. As noted by McDonald J. in *First Edmonton*, at 132, quoting from the *Detailed Background Paper for the New Canada Business Corporation Bill*, at 2, one of the central objectives of the task force, was:

> [T]o create a practical balance of interests among shareholders, creditors, management, and the public, a balance that ensures both adequate investor protection and maximum management flexibility in the overall context of the public interest.

[400] This ‘balanced’ approach represented a marked departure from the traditional common law view of ‘majority rule’ which dictated the courts’ non-interventionist stance *vis-à-vis* the internal management of a company: *Shuttleworth* v. *Cox Bros. and Co. (Maidenhead), Ltd.*, [1926] All E.R. Rep. 498 (C.A.).[30] Thus, although derived from s. 210 of the United Kingdom *Companies Act 1948* (U.K.), 1948, c. 38 the oppression provisions of the *CBCA* (s. 234) were much broader than any other legislation in any other jurisdiction at that time (*First Edmonton*, (Q.B.), at 138).

[29] However, one must be careful in relying upon authorities which interpret other provincial Acts, because, as Egbert J. noted in *Stech v.Davies* (1987), 53 Alta L.R. (2d) 373 at 378 (Q.B.), referencing *Diligenti* v. *RWMD Operations Kelowna Ltd. (No. 1)* (1976), 1 B.C.L.R. 36 (S.C.), the sections of some provincial acts are not as wide as the Alberta statute. McDonald J. made a similar observation in *First Edmonton*, at 155.

[30] Thus, one must be very careful in applying old cases espousing traditional common law corporate principle. This caution was given by Moore C.J. in *Westfair Foods Ltd.* v. *Watt* (1990), 106 A.R. 40 at 49 (Q.B.), (1992), 4 Alta. L.R. (3d) 268 (C.A.), application for leave dismissed [1998] S.C.C.A. No. 634, and the Ontario Court of Appeal in *Re Ferguson and Imax Systems Corp.* (1983), 43 O.R. (2d) 128 at 137 (C.A.), leave to appeal dismissed (1983) 20 O.A.C. 158 (S.C.C.).

[401] The broader scope of the remedy under both the *CBCA* and the *ABCA* was largely the result of the extended definition of "complainant" and the fact that these Acts provided for three categories of prohibited conduct which would give rise to an oppression remedy, namely:

> (a) oppressive conduct;
> (b) conduct which is unfairly prejudicial; or
> (c) conduct which unfairly disregards the rights of one of the groups specified in the *Act*.

[402] It has been suggested that the unifying theme throughout these three categories of conduct, is whether the conduct is "unfair": The Alberta Institute of Law Research and Reform, *Report on Proposals for a New Alberta Business Corporations Act* (Report No. 36), Vol. 1 (August 1980), at 142. That suggestion is consistent with Lord Cooper's statement in *Elder and others* v. *Elder and Watson Limited*, [1952] S.C. 49, which is often cited as the threshold or foundation for entitlement[31] to the oppression remedy in Canada (at 55):

> [T]he essence of the matter seems to be that the conduct complained of should at the lowest involve a visible departure from the standards of fair dealing, and a violation of the conditions of fair play on which every shareholder who entrusts his money to a company is entitled to rely.

[403] It follows that, in the context of a shareholder, the inquiry becomes: "Is the conduct unfair to the shareholder": *First Edmonton* (Q.B.), at 140, quoting from *Report on Proposals for a New Alberta Business Corporations Ac, supra* at 141-142.

c. Statutory Interpretation

i. Unfairness and Reasonable Expectations

[404] No statutory definition of "unfairness" is provided for the purpose of applying the legislation. Guidance in that respect has developed through the case law. Indeed this was the legislator's intent. As set out by Dickerson, *Proposals For a New Business Corporations Law for Canada, supra,* at para. 484:

> ... the courts should have very broad discretion, applying general standards of fairness, to decide these cases on their merits.

[405] Having been charged with the task of exercising its equitable jurisdiction to determine what constitutes unfairness in each particular case (*Westfair*, per Moore C.J., at 51), the courts have prescribed a liberal and broad interpretation to the section. Such an interpretation has

[31] See also: *First Edmonton Place* (Q.B.); *Diligenti, supra*; *Keho Holdings Ltd. and Oliver* v. *Noble* (1987), 78 A.R. 131 (C.A.); and Dickerson, *Proposals For A New Business Corporations Law for Canada*, *supra*, at 163.

permitted the provisions to carry out their intended purpose: *Stech* v. *Davies, supra,* at 380; *Keho Holdings, supra,* at 136 (C.A.); *Re Ferguson,* at 137; and *Westfair, supra,* at 369 (C.A.))

[406] Although the application of the section will be very fact specific, McDonald J. in *First Edmonton,* at 146, listed some of the factors that may be relevant in determining whether conduct is unfair, namely: the history and the nature of the corporation; the essential nature of the relationship between the corporation and the creditor; the type of the rights affected; and general commercial practice.

[407] J.A. Campion, S.A. Brown and A.M. Crawley in "The Oppression Remedy: Reasonable Expectations of Shareholders", *L.S.U.C., Special Lectures 1995: Law of Remedies* (Toronto: Carswell, 1995) at 229, suggest that there were two overriding principles which emerged from the analysis in *First Edmonton* (Q.B.): (1) the underlying expectations of the stakeholder are the interests which the oppression remedy seeks to protect; and (2) the need to balance the interests of the stakeholder against the right and duty of the management to act in the best interests of the corporation, despite that it may require acting to the prejudice of the stakeholder.

[408] The list of considerations set out by McDonald J. was expanded by Moore C.J. in the trial decision in *Westfair* to include (at 53): the history of the corporation; the type of interests affected; general commercial practice; the nature of the relationship between the complainant and alleged oppressor; the extent to which the impugned conduct was foreseeable; the expectations of the complainant; the impact of the conduct upon a stakeholder's interests; and the size, structure and nature of the corporation. In so doing, Moore C.J. also applied a reasonable expectations analysis.

[409] In varying the decision in *Westfair,* the Court of Appeal, per Kerans J., found that the legitimate expectations of a party are the starting point for a determination of what is fair.

[410] Campion observed, at page 248, that:

> The relationship between the principle of shareholders' reasonable expectations and the oppression remedy is notable for its justificatory coherence. In the event that a shareholder's reasonable expectations have been breached, a situation may exist which is unfairly prejudicial to the interests of that shareholder. The unfairness emanates from the breach of the reasonable expectations. The prejudice necessitating relief is the detriment suffered by the shareholder as a result of the breach of their expectations.

[411] Today the reasonable expectation assessment has become the generally accepted approach to determining whether corporate conduct may be characterized as "unfair". As noted by D. Peterson in *Shareholder Remedies in Canada,* at para. 18.101.1:

> As the oppression remedy jurisprudence has developed, "reasonable expectation analysis" has become the standard analytical tool. It has been said that "[t]he

> unifying thread of the oppression remedy is to protect such reasonable expectations" of corporate stakeholders. [Citations omitted.]

[412] In terms of what constitutes reasonable expectations, D. Peterson, cites a number of examples of expectations that courts have found to be reasonable and worthy of protection at para. 18.101.1:

> (a) shareholders are entitled to a reasonable expectation that directors will fulfil their fiduciary duty and act lawfully: *Palmer* v. *Carling O'Keefe Breweries of Canada Ltd.* (1989), 67 O.R. (2d) 161 at 170 (Div. Ct. - VanCamp, Southey and MacFarland J.J.);
> (b) *shareholders have a reasonable expectation that their corporate contractual obligations will be adhered to*, unless there is no basis to infer such reasonable expectations from the agreement: *West* v. *Edson Packaging Machinery Ltd.* (1993), 16 O.R. (3d) 24 at 29 (Gen. Div. - Sullivan J.), and *Schicchi* v. *Orveas Bay Estates Ltd.* (1994), 98 B.C.L.R. (2d) 391 (S.C. - Melvin J.);
> (c) a fundamental reasonable expectation of a shareholder is for management to maintain basic records and not co-mingle corporate funds with those of non-related enterprises: *Lee* v. *To* (1998), 39 B.L.R. (3d) 293 (Sask. C.A. - Tallis, Cameron and Wakeling J.J.A.); and
> (d) the legitimate expectation of shareholders is that the business will not fail and will not liquidate. Therefore, the company has a duty of prudent management to forestall that event. It can be brought to account if it strips the company of its assets or adopts a liquidation policy: *Westfair* (D.L.R.) 48 at 54-56 (Alta. C.A - Harradence, Kerans and Cote J.J.A.). [Emphasis aded.]

[413] Campion summarized shareholder expectations (at 233-234) as follows:

> They include expectations as to the nature of the business invested in, the corporate structure, the ownership structure, the financial structure of the corporation and the source of the control of the business and affairs of the corporation.
>
> In addition to these expectations, which will vary depending on the nature of the corporation invested in, there are various norms of corporate law that shareholders may be presumed to expect:
>
> - that the business and affairs of the corporation will be managed by a board of directors which will act in the best interest of the corporation;
> - that shareholders have no right to manage the business and affairs of the corporation except to the extent that they have removed such powers from the board of directors pursuant to a unanimous shareholders' agreement;
> - that the extent of any obligations owed by and between shareholders will be pursuant to an agreement between the shareholders; and

- that majority rule is the touchstone of corporate governance.

ii. The Three Grounds of Prohibited Conduct

[414] The case law also provides guidance as to the scope of the three types of conduct that will ground an oppression remedy, namely: oppressive conduct; unfairly prejudicial conduct; and conduct which unfairly disregards the rights of specified groups. While these categories of conduct are not mutually exclusive, the courts have developed distinct definitions for each.

[415] The definition of ‘oppression’ has been held to incorporate an ‘abuse of power’ situation whereby the majority is able to perpetrate abuses because of the imbalance of power: *Scottish Co-Operative Wholesale Society, Ltd.* v. *Meyer and another*, [1958] 3 All E.R. 66 (H.L.).

[416] The latter two terms in s.234(2) have been interpreted as providing more latitude for a finding of prohibited behaviour. This position is supported by the historical development of the section, which suggests that the remedy is designed to protect both legal and equitable rights and therefore should be afforded a wide scope: *Re. Mason and Intercity Properties Ltd.* (1987), 59 O.R. (2d) 631 (C.A.), leave to appeal dismissed (1987), 62 O.R. (2d) ix (S.C.C.).

[417] The words ‘unfairly prejudicial’ denote that there is an imbalance between the interested parties of a corporation, and that there is an inequality of treatment with no justifiable reason (*Stech, supra*).

[418] Additionally, in *First Edmonton,* McDonald J. adopted the statement of Professor Shapira in “Minority Shareholder’s Protection” (1982), 10 N.Z.L. Rev. 134, commenting:

> More concretely, the test of unfair prejudice should encompass the following considerations: the protection of underlying expectation of shareholders in closely held companies, and the detriment to the members’ proprietary interest.

[419] The phrase “unfairly disregards the interests of” is arguably the lowest threshold of prohibited conduct which must be shown in order to obtain an oppression remedy. This phrase also suggests that there has been unjust treatment of one of the parties and the use of the word ‘interests’ implies that the definition extends beyond a stakeholder’s strict legal rights.

[420] In *Stech*, Egbert J. at 379, interpreted the phrase to mean “to unjustly and without cause ... pay no attention to, ignore or treat as of no importance the interests of security holders, creditors, directors or officers of a corporation”.

[421] Campion suggested that “unfairly disregards” is the appropriate ground under which to deal with procedural complaints.

iii. Good Faith

[422] The broad definitions applied to the prohibited grounds of conduct, particularly the latter two, have resulted in a clear shift away from focussing on the intention of the corporate actor to focussing on the impact of the conduct upon the interests of the security holder, creditor, shareholder, director or officer. The adoption of the reasonable expectations analysis has also had an unavoidable impact on the requirement for a finding of bad faith as a prerequisite to a finding of oppression. McDonald J. in *First Edmonton* noted, at 144, that:

> *Diligenti* demonstrated a new direction. Whereas in the past good faith and the constitutional power of the directors and the majority had been critical, the emphasis shifted to the damaging effect on the interests set out in s.234 (see: Professor Shapira's article at p. 149).

[423] Similarly, in *R.S.* v. *RW-LB* (1993), 147 A.R. 241, Mason J., following an extensive review of the case law, stated at paragraph 64:

> Based on these authorities, I consider that proof of want of probity or *mala fides* is not essential in establishing an oppression action and the right to obtain a remedy from the court.

See also: Shapira, at 145.

[424] The requirement of a finding of *mala fides* to support a finding under the "unfairly prejudicial" and "unfairly disregards" grounds for liability was specifically considered by the Ontario Court of Appeal in *Brant Investments* v. *KeepRite Inc., supra,* at 176:

> In considering whether conduct is "*oppressive*" one can appropriately look to the English cases decided before 1980 which defined that word in a similar context. Adopting the definition applied by Lord Simonds in the *Scottish Co-Operative* case - namely "burdensome, harsh and wrongful" - it is unlikely that an act could be found to be oppressivewithout there being an element of bad faith involved. However, in considering the alternative question of whether any act is *unfairly prejudicial* to, or *unfairly disregards the interests* of one of the protected persons or groups, I am of the view that a requirement of lack of *bona fides* would unnecessarily complicate the application of the provision and add a judicial gloss that is inappropriate given the clarity of the words used. Of course, there may be many situations where the rights of minority shareholders have been prejudiced or their interests disregarded, without any remedy being appropriate. The difficult question is whether or not their rights have been prejudiced or their interests disregarded "unfairly". In testing the facts in a given case against the word "unfairly", evidence of bad faith as to motive could be relevant, but there may be other cases where particular acts effect an unfair result, but where there has been no bad faith whatsoever on the part of the actors. [Emphasis added.]

See also: *Lyall* v. *147250 Canada Ltd.* (1993), 84 B.C.L.R. (2d) 234, at para. 35 (C.A.).

d. Summary of Oppression Principles

[425] In summary, the purpose of the oppression remedy is to provide an avenue for minority stakeholders, including both shareholders and creditors, to protect their interests from harmful corporate decisions. The central focuses in the determination of whether a party is entitled to relief under the oppression remedy are: the reasonable expectations of the stakeholder; the unfairness or prejudice of the conduct in light of these expectations; and the impact of the conduct upon the stakeholder's interests.

e. Application of the Remedy in other Cases

[426] While the underlying principles and purpose of the remedy are clear, the wide statutory language results in decisions that are highly fact orientated. *Re Ferguson* is authority for the observation that one should be cautious in making any direct comparison between the various oppression cases. Nonetheless, a review of oppression cases from Alberta, as well as other jurisdictions, is helpful in developing a flavour for the types of circumstances that will give rise to an oppression remedy. I have included herein a summary of only those cases which bear some factual resemblance to the case at Bar.

[427] In *Re Ferguson*, three couples were shareholders in a corporation. The complainant and her husband divorced and she argued that her former husband was trying to push her out of the business and prevent her from receiving dividends. The Ontario Court of Appeal found that the husband's actions and those of the other directors who succumbed to the husband's will, demonstrated conduct which was oppressive and unfair. The Court, however, reversed the trial judge's remedy of dissolution in favour of individual remedies where oppression was found. There the Court specifically found that the offending majority shareholder treated the company:

> ... as his personal domain. He acted improperly and his conduct [could] only be characterized as prejudicial to [the company] and its shareholders.

[428] In *Stech*, Egbert J. found that the actions of one of the two equal shareholders, in dealing with the assets of the two corporations, were taken unilaterally and without notice to the other shareholder. The Court granted an oppression remedy, separating the corporations into two wholly owned corporations and requiring the determination of the value of the shares. In the process, Egbert J. noted that for conduct to be considered offensive it should, at a minimum, represent a departure from "fair play".

[429] In *First Edmonton*, McDonald J., at 141, agreed with Professor M.A. Waldron's recognition, in "Corporate Theory and the Oppression Remedy" (1981-82), 6 Can. Bus. L.J. 129 at 151, that the concept of unfairness extended the oppression remedy to "a general range

of unfair conduct: [including] ...*unfairness in ignoring previous ... agreements among shareholders about their future relationships*....”. [Emphasis added.]

[430] In *Liu*, *supra*, the corporation borrowed from investment groups in which the directors were interested. None of those directors abstained from voting on the loan. A debenture was granted as security for the loan. Within a couple of weeks a demand for payment was made, followed shortly by the appointment of a manager/receiver. The Court found that the effect of the impugned transactions did not constitute oppression, under the more restrictive B.C. legislation, but that the only possible complaint was one of breach of fiduciary duty. Specifically, the Court held (at para. 13), that:

> ... in general terms, the motive behind conduct alleged to be prejudicial or oppressive is “largely immaterial”, and that the *effect* of the actions is key.

[431] In *Sahota* v. *Basra* (1999), 45 B.L.R. (2d) 143 at paras. 29-30 (Ont. Gen. Div. - MacKenzie J.) the Court dismissed an argument that a causal connection between unfair treatment and a corresponding tangible detriment suffered by the complainant, was unnecessary. That finding was based on the rationale that the underlying purpose of the remedy is to protect interests, and the apprehension of detriment suffered by the complainant was sufficient.

[432] The case of *Lyall*, *supra*, relied upon by Mason, is instructive to the case at Bar. There the Plaintiff and two others owned the shares of the Defendant company, which was incorporated for the purpose of facilitating the sale of shares of the group to a third party. There was a unanimous shareholders agreement which the Court concluded modified the bylaws of the company so as to require unanimous approval of a resolution to repudiate the share purchase agreement. The British Columbia Court of Appeal held that, contrary to that requirement, the two other directors had purported to approve such a resolution contrary to the wishes of the Plaintiff, thereby causing the company to embark upon a course of action without authorization. The Court concluded that the Plaintiff had been prejudiced as a result.

[433] The Court in *Lyall* found that the actions of the two directors unfairly prejudiced and unfairly disregarded the complainant and his interests. In the result, the Court held (at para. 46) that the decision of the two “was therefore made without regard to the rights of [the Plaintiff] to express his approval or disapproval to the Unanimous Shareholders Agreement”. Further, at paras. 48-50, Legg J.A. for the Court stated that:

> At a minimum, Lyall, *as a shareholder of the Company ..., was entitled to expect from the other shareholders and directors that in making corporate decisions, they would respect and adhere to the provisions of the Unanimous Shareholders Agreement....*
>
> The acts of [the other two] ... constituted a wrong to Lyall in that they *breached the Unanimous Shareholders Agreement* entered into with him *and abrogated his*

> *legitimate interests and expectations as a shareholder of the Company....* [Emphasis added.]
>
> By causing the Company to repudiate the Share Purchase Agreement [without Lyall's approval of a unanimous resolution], [the other two] caused the Company to embark upon a course of action outside its ordinary course of business. *Under the Unanimous Shareholders Agreement, [the other two] had no authority by themselves to effect such a fundamental change in the business of the Company. They required the express consent of Mr. Lyall to do so. The actions of [the other two] can only be regarded as unfairly prejudicial to Lyall's interests.*

[434] In *Lyall*, the Court based its finding of prejudice on the fact that the Complainant, absent the Court's finding, would have to pay 1/3 of the substantial litigation costs the Defendants had incurred in unsuccessfully avoiding the sale, plus all of his own legal costs in taking a contrary position. In terms of a remedy, the Court awarded the Complainant his legal expenses to the extent that they were reasonably and necessarily incurred as a result of the conduct of the Defendants.

[435] *Redekop* v. *Robco Construction* (1978), 89 D.L.R. (3d) 507 (B.C.S.C.), dealt with the issue of *mala fides* in the context of a director's breach of duty. In that case the director and majority shareholder of the corporation *negotiated a contract with another corporation in which the director held shares, without complying with the disclosure provisions of the Act*. The Court held that conduct of that nature was oppressive as the director had helped himself using the corporation's assets.

[436] In *Main* v. *Delcan Group Inc.* (1999), 47 B.L.R. (2d) 200 (Ont. Sup. Ct.), Lederman J. of the Ontario Superior Court of Justice [Commercial List] dealt with a case wherein a group of retired employees offered shares for sale to active employees pursuant to a shareholders' agreement. The corporation purchased a number of shares itself in a manner which breached the shareholders' agreement and the *CBCA*. The Court observed, at p. 211:

> The case of *218125 Investments Ltd.* v. *Patel* (1995), 33 Alta. L.R. (3d) 245 (Q.B. - Rooke J.) is authority for the position that the Shareholders' Agreement can be used as a guide when determining the reasonable expectations of the shareholders. In the case at bar, the 1994 *transaction directly violated the provisions of the Shareholders' Agreement. In the absence of clear acquiescence by the Applicant shareholders, an action in violation of the Shareholders' Agreement and the CBCA cannot possibly be said to be reasonably expected by the Applicants*. Nor can the Business Judgment Rule be applied in such circumstances in order to prevent judicial intervention. [Emphasis added.]

[437] I have also considered the following cases where the oppression remedy has been applied, but which do not add materially to my considerations on the facts, or the development of the law:

- *Goldex Mines Ltd.* v. *Revill* (1974), 54 D.L.R. (3d) 672 (Ont. C.A.);
- *Neri* v. *Finch Hardware (1976) Ltd.* (1995) 20 B.L.R. (2d) 216 (Ont. G.D. - Feldman J.);
- *Jackman* v. *Jackets Enterprises Ltd.* (1977), 4 B.C.L.R. (S.C. - Fulton J.);
- *Bank of Montreal* v. *Dome Petroleum Ltd.* (1987), 54 Alta. L. R. (2d) 289 (Q.B. - Forsyth J.);
- *Calmont Leasing Ltd.* v. *Kredl* (1993), 142 A.R. 81 (Q.B. - Russell L.), upheld (1995), 165 A.R. 343 (C.A.), varied (1995) 32 Alta. L.R. (3d) 345 (C.A.);
- *Wright* v. *Rider Resources Inc.* (1994), 159 A.R. 321 (Q.B. - Hunt J.);
- *Arrotta* v. *AVVA Light Corp.* (1995), 175 A.R. 299 (Q.B. - Sullivan J.), appeal allowed on the summary judgment and a new trial ordered on the merits (1995) 78 A.R. 100 (C.A.);
- *Argali Holdings Inc.* v. *Hoal Investments Ltd.* (1995), 175 A.R. 335 (Q.B. - Clarke J.);
- *400280 Alberta Ltd.* v. *Franko's Heating & Air Conditioning (1992) Ltd.* (1995), 166 A.R. 241(Q.B. - Hart J.);
- *218125 Investments Ltd.* v. *Patel*, *supra*;
- *Three Point Oils Ltd.* v. *Glencrest Energy Ltd.*, [1997] A.J. No. 451 (C.A.);
- *Clarke* v. *Rossburger*(1999), 254 A.R. 30 (Q.B. - Cairns J.);
- *HSBC Capital Canada Inc.* v. *First Mortgage Alberta Fund (V) Inc.* (1999), 247 A.R. 37 (Q.B. - Paperny J.);
- *Alberta (Treasury Branches)* v. *Seven Way Capital Corp.* (2000), 261 A.R. 278 (C.A.); and
- *Mikulak* v. *Rubin*, 2001 ABQB 594;

f. Application of the Remedy to the Case at Bar

[438] As noted *supra*, fairness is the threshold for oppressive conduct.

i. Billes

[439] In the case at bar, it is clear that Mason's reasonable expectations have been breached in several ways.

1. Failure to Disclose

[440] The most obvious disregard for Mason's interests was the failure of Billes to disclose the fact, and provide the details, of her interest in both of DDL's major Lenders.

[441] Further to the failure to make disclosure, the Loans in question were approved in violation of the USA and the *ABCA*. The USA clearly provided that where a director has an 'interest' in a financial decision, the director should abstain from voting. Where 50 percent or more of the

board was ineligible to vote, the decision had to be put to the shareholders for determination. Billes was one of two directors and therefore was holding 50% of the votes of the Board of Directors. At a minimum, this would require shareholder notice to Mason (which was not given). As McAteer only held 10% of the shares, it would have been impossible for the transaction to be approved by a shareholder vote without the inclusion of Mason. Not only was the *ABCA* breached, but the USA was ignored.

[442] This case is similar to *Lyall*. In the case at Bar the USA modified the bylaws of DDL to require a resolution of the shareholders of DDL to approve the loan. The failure of Billes and McAteer to put the Loans decisions to the shareholders, as required by the USA, deprived Mason of her right to approve or disapprove the Loans. By requiring her approval, she had the right to avoid the risk associated with the Loans by refusing approval, or selling her shares (as she tried to do to Billes after October 8, 1992, but was rejected out of hand), or making some other arrangement to protect the position of her children.

[443] Due to the failure of McAteer and Billes, Mason was deprived of the opportunity and otherwise helpless to avoid the ultimate downfall of DDL and the loss of the shareholder's position she held in the interest of her children. The result in my view was to unfairly prejudice her, and certainly to proceed while unfairly disregarding her rights as a shareholder under the USA. In either case, she is entitled to relief.

[444] *Liu* may appear, at first blush, to have arrived at a contrary conclusion, despite similar circumstances. However, the facts in *Liu*, are significantly different from those in the case at Bar. In *Liu*:

a. there was no USA;
b. the shareholder had a right to vote on declaration of their interest; and
c. the trial judge found that the Plaintiffs had suffered no damage.

None of those factors are present here.

2. The $200,000 Loan

[445] In addition to the failure to disclose and obtain shareholder approval, Billes and McAteer took personal benefits from the increase in the amount of the Newmat Loan. Specifically, the Newmat Loan was increased from $1.9 million to $2.1 million in order that McAteer could receive $200,000.00 and repayment of his non-interest bearing shareholder loan. Billes, in turn, received sole ownership of the Wolfe Street property. This transaction clearly indicates that Billes and McAteer were treating the assets of DDL as though they were their own personal assets. Moreover, the last $100,000.00 of this loan was advanced less than two months prior to McAteer's letter on behalf of DDL requesting a reduction in interest and citing difficulty in payment. This would indicate that it was not in DDL's interests to be repaying non-interest bearing, shareholder's loans at a time when it must have been obvious that DDL was in

serious financial trouble. It is certainly indicative that no regard was given to Mason's lack of interest in the Wolfe Street transaction.

[446] In my view this is not dissimilar from the situation in *Keho*. In that decision, at 137, Haddad J.A. discussed the principle shareholder's conduct in arranging for a loan without the approval of the board of directors, which loan was for the benefit of his personal corporation:

> A disturbing aspect of Oliver's conduct is that he seems to have considered his position beyond challenge by using Keho's line of credit to his personal advantage. *He treated Keho as his personal domain. He acted improperly and his conduct can only be characterized as prejudicial to Keho and its shareholders.* [Emphasis added.]

Haddad J.A. concluded that such conduct failed to meet the applicable standard of fairness.

[447] In the present circumstances, I find that Mason had a legitimate right to expect that Billes and McAteer would not disregard the interests of DDL and the other shareholder, Mason herself, in order to derive a personal benefit for themselves. In so doing I find that Billes and McAteer acted in a manner which was unfairly prejudicial and unfairly disregarded Mason's interests.

3. The Effect of Those Acts as a Whole

[448] In *Calmont Leasing Ltd.* v. *Kredl* (1995), 165 A.R. 343, the Court of Appeal found that a piecemeal approach in looking at the alleged wrongs is unnecessary and that the trial judge can look at all of the matters complained of together in order to sustain a finding of oppression or unfair conduct within the meaning of the *ABCA*. Accordingly, even if one of the acts enumerated above would be insufficient to find oppressive conduct or conduct which unfairly prejudiced the rights of the other shareholder or disregarded her interest, I am satisfied that the acts when considered together are more than sufficient to ground such a finding against Billes. However, that said, the primary infringing act was the lack of disclosure and consent contrary to the USA and *ABCA*.

[449] It was argued by BJ (in the context of remedies for failure to disclose) that, contrary to being oppressive or not in the best interests of DDL and its shareholders, the Kingswood Entities and DDL's shareholders were given a new lease on life by the Trust Loan. Accordingly, it submits that there is no equitable reason to consider providing a remedy as there was no "wrong" that needs to be "remedied".

[450] I agree with BJ *vis-à-vis* DDL, but not *vis-à-vis* Mason as a shareholder, whose personal interests may well have been different than those of DDL. Specifically, the detriment to Mason, as a shareholder, was that it increased her risk that the shares she held for the Mason/McAteer children might become (as it turned out) worthless. The "wrong to be remedied" was depriving

Mason of the choice, as a shareholder, to participate or not participate in the Loans which, while creating an opportunity for DDL, also created a risk for her as a trustee shareholder.

[451] It was also argued that, had disclosure been made, Mason would have approved the transactions in any event. This argument is premised on the fact that the Loans were supported by McAteer and he would not have done anything to harm the interests of his children. Moreover, it was argued that these transactions would allow DDL to proceed with its Kingswood developments and increase the value of the shares of DDL, and that Mason would have seen this herself or been convinced by McAteer.

[452] The arguments amount to: what would Mason have done if she had knowledge of Billes' interests.

[453] Specifically Billes argued:

> ...the Court ought to determine that even if Mason was not apprised and did not consent to these loans (we submit the Court should determine that she was and she did), she would have approved these loans if asked. We make this submission on the basis of her own evidence that McAteer was the manager, that McAteer was looking after the family interests regarding DDL, that if McAteer was happy she was happy, that she knew funding was required, and that she expected Billes to be a financial partner, and that she was content to rely on the Directors' assessment of what was in the best interests of DDL. We also refer to Mr. Cristall's evidence that no other financing was available and that the terms of these loans were fair and reasonable. It lies ill in Ms. Mason's mouth to complain about the terms and the loans.

[454] I do not agree. Let us be clear as to a number of fundamental matters:

(a) Mason was neither an officer, nor director, but rather a 40% shareholder (for the Mason/McAteer children);
(b) Mason had the right to believe that she had the security of the USA in place and had *no obligation* to search out information to determine the details of what was happening financially at DDL, nor did she appear to be the "active" investor inclined to do so. She was not involved in the day to day management of DDL at any time before or after April 23, 1990, and in her cross by TM she acknowledged that she was "not a business person", "not familiar with those things..." and that she "did not interfere or get involved with the company either before or after Billes became a partner". This was even more the case as she was getting general oral information on the progress of the Kingswood project;
(c) Mason had *no obligation* to investigate to ensure - rather she had the right to expect that - Billes and McAteer were obeying the USA and the *ABCA*; and
(d) Billes had *an obligation* to obey both the USA and the *ABCA*, to disclose her material interests in writing, to refrain from voting as a director in support of the Loans, and to

> get Mason's shareholder's consent in writing. Moreover, Billes knew this as is witnessed at the time when the Newmat Loan was still proposed as an Albikin loan, she was aware of the need for shareholder approval (Exhibit 55, p.2, para.1). However, she relied on McAteer in this regard.

[455] Accordingly, I do not find the argument that Mason would have approved the Loans, had adequate disclosure been made, or any similar arguments, convincing. In other words, I find that Billes has failed to demonstrate, on a balance of probabilities, that Mason would have consented to the Loans. In that regard I note that Mason tried to sell her interests in DDL when trouble arose in October 1992, between Billes and McAteer. I see no reason why she might not have done so in February or October, 1991 when these transactions were being negotiated. She might well have felt that there was too much risk for her children and asked McAteer or Billes to buy out her interest and this might well have taken place at that time (indeed, she so enquired of Lavery in December 1992 and he made enquires of Billes and told Mason that Billes was not then interested). She was not asked about this hypothesis in her evidence - perhaps for good procedural or tactical reasons.

[456] In any event these arguments overlook the fact that, by their conduct, Billes and McAteer abrogated Mason's right as a shareholder under the USA and deprived her of her right to participate in the decision itself.

[457] Billes argued that if there was a defect in the Loans and she were found to be culpable it would only be to a very minor degree. She submitted further that, in assessing whether her conduct was oppressive, the Court ought to consider: the concessions that were provided by the Lenders in allowing DDL time until the Loans were called; the subsequent Standstill Agreement; Albilkin's agreement to advance (if appropriate) and the actual advance of some additional funds; and the ultimate reasonableness in calling the Loans. Taking all of these considerations into account Billes submitted that her conduct cannot be characterized as oppressive.

[458] These factors do not in my view, excuse Billes. Had I based my finding in favour of an oppression remedy on the enforcement of the Loans, and Billes' involvement therewith while still a director of DDL (as argued by Mason on the authority of *Scottish Co-Operative Wholesale),* the above considerations might be more persuasive. However, as I have found that it was Billes' failure to disclose and her taking of personal benefits at the expense of DDL which ground an oppression remedy, the above factors can not exonerate her from liability to Mason.

[459] Although I have found no bad faith to exist on Billes' part, such a finding is not necessary. It is the conduct and its effects which are important. In all of the circumstances of this case, I find that Mason's interests have been unfairly disregarded and prejudiced.

ii. McAteer

[460] I have found Billes liable to Mason under the oppression remedy. The issue arises as to whether McAteer should also be liable under the oppression remedy. In this regard the Mason

Action alleges that McAteer wrongfully permitted DDL to enter into the Trust and Newmat Loans in breach of the USA and the *ABCA*, and wrongfully or negligently signed Officer's Certificates when he knew the statements therein were false and concealed the existence of the Trust and Newmat Loans.

[461] McAteer argued:

> We agree that the failure of Billes to disclose her interest in both the Trust and Newmat may lead to an oppressive remedy. The duty which was breached was the duty of Billes and not McAteer. In the event this Court finds that Billes breached her duty and the appropriate remedy is the oppressive remedy, then Billes and her related entities ought to be held accountable. McAteer ought not to bear any liability.

[462] Indeed, McAteer went further and argued that he ought to be considered a joint complainant in respect of this oppressive conduct. However, McAteer has not pled to this effect. Further, although he is capable of falling within the definition of complainant under s. 231(b) of the *ABCA*, I find that McAteer was a participant in the oppressive conduct rather than a complainant as a result of having engaged in conduct which was unfairly prejudicial and which unfairly disregarded Mason's rights as a shareholder. The specific conduct which I am referring to includes that alleged by Mason, including, but not necessarily limited to, the following:

> (a) McAteer had actual knowledge of the terms of the USA and the requirements for shareholder approval of the Loans when a director was in a conflict of interest situation;
> (b) McAteer had actual knowledge of Billes' conflicts of interest and knew, or ought to have known, that she was in a conflict of interest position with DDL in respect of each of the Loans;
> (c) McAteer knew that no shareholder resolutions on behalf of DDL had been signed approving either the Trust Loan or the Newmat Loan and he knew that no shareholders meetings had been called to seek approval for either of these Loans;
> (d) McAteer knew that his assertions in the Officer's Certificates that "the Company is not bound by any provision in . . . any Unanimous Shareholder Agreement which would in any way hinder or restrict the powers of the Company or the officers of the Company to authorize, execute and deliver the debenture" were false on the facts;
> (e) McAteer received the benefit of the $200,000 Loan by way of a reduction in his non-interest bearing, unsecured, shareholders loan. As outlined *supra*, this was done without the knowledge or consent of Mason;
> (f) McAteer knew that Billes believed on the basis of his misrepresentation that he would and did make the appropriate disclosure to and obtain Mason's consent in a manner that was consistent with the *ABCA* and USA.

[463] In the end result, I find that McAteer and Billes are jointly and severally liable to Mason under the oppression remedy.

g. Form of Remedy

[464] The next issue is the appropriate form of remedy. The oppression provisions provide wide powers for the creation of an equitable remedy tailored to fit the circumstances. The Court's broad discretion in this context is, however, limited by the qualifications that it is to be exercised only to rectify the oppression and may protect the complainant's interests only as a shareholder: *Naneff* v. *Con-Crete Holdings Ltd.*(1995), 23 O.R. (3d) 481 (C.A.).

[465] In fashioning a remedy appropriate to the circumstances I have also had regard to the comments of Farley J. in *82009 Ontario Inc.* v. *Harold Ballard Ltd.* (1991), 3 B.L.R. (2d) 113 at 197 (Ont. Gen. Div.), aff'd (1991), 3 B.L.R. (2d) 113 (Ont. C.A.):

> The court should not interfere with the affairs of a corporation lightly. I think that where relief is justified to correct an oppressive type of situation, the surgery should be done with a scalpel and not a battle axe. I would think that this principle would hold true even if the past conduct of the oppressor were found to be scandalous. The job for the court is to even up the balance, not tip it in favour of the hurt party.

[466] In this case, there is no value left in DDL to salvage. The only logical remedy to compensate Mason for the improper conduct of McAteer and Billes is to value her interest and to restore her to the position she held at a point in time when the conduct had not yet occurred. To suggest any other remedy would involve speculation as to whether she would have approved the Loans if the requisite disclosure had been made, or that DDL would have failed in any event.

[467] The ability to assign responsibility to directors or officers personally for oppressive corporate conduct was confirmed in *Budd* v. *Gentra Inc.* (1998), 111 O.A.C. 288 (C.A.). The Court found, at para. 46:

> A director or officer may be personally liable for a monetary order under that section [the oppression provisions] if that director or officer is implicated in the conduct said to constitute the oppression and if in all of the circumstances, rectification of the harm done by the oppressive conduct is appropriately made by an order requiring the director or officer to personally compensate the aggrieved parties.

[468] I am satisfied that the pleadings and evidence disclose facts which support a monetary order against Billes and McAteer personally. As above, I am also satisfied that both McAteer and Billes are guilty of the conduct that constitutes the oppression. Accordingly, I find that it is

appropriate in the circumstances to rectify the harm done by ordering them to compensate Mason as an aggrieved party, pursuant to s. 234(3)(l) of the *ABCA*.

[469] I have undertaken the determination of the appropriate amount of those damages later in these Reasons.

2. Constructive Trust

[470] Mason and McAteer, under the damage components of the Mason and McAteer/Kingswood Actions, contended that if a director of a company breaches his or her fiduciary duties and misapplies the funds of a company so that they come into the hands of a stranger who receives them with knowledge of the breach, actual or constructive, the stranger cannot retain those funds. The stranger in those circumstances in effect becomes a constructive trustee in relation to the funds and the transaction is thus invalid and ought to be set aside. In that regard Mason and McAteer relied on *Rolled Steel Products (Holdings) Ltd.* v. *British Steel Corporation and Others*, *supra* at 88, quoting *Belmont Finance Corporation Ltd.* v. *Williams Furniture Ltd. (No. 2),* [1980] 1 All E.R. 393 at 405 (C.A.):

> The *Belmont* principle thus provides a legal route by which a company may recover its assets in a case where its directors have abused their fiduciary duties and a person receiving assets as a result of such abuse is on notice that they have been misapplied.

[471] Applying those principles to the case at hand, McAteer and Mason argue that, although Billes may have disclosed that she had *an* interest in the Lenders to McAteer, she was bound by the provisions of the USA to disqualify herself from taking any part in the decision to enter into the Loans. In that regard McAteer cites *Anderson Lumber Co.* v. *Canadian Conifer Ltd.*, *supra*. The directors of DDL were compelled to refer the matter to the shareholders of DDL to decide. Thus, the decision was not within the capacity or authority of the directors. I agree so far.

[472] It was further argued by Mason and McAteer that because the Lenders had knowledge of the breach of Billes' duties to DDL, constructively via Billes (no actual knowledge is alleged), the Loans are void, the Lenders are constructive trustees for the security pledged and DDL is entitled to the return of its property. I do not agree. Quite simply, I find Billes did not know of the lack of compliance because she relied on McAteer to obtain (and believed that he had obtained) Mason's consent. Therefore, if Billes did not know of the breach, neither did the Lenders, through her. I further have found that the Lenders had no knowledge of breach from any other source.

[473] Moreover, there may also be an argument that Billes' knowledge is not the knowledge of the Lenders. The Court of Appeal in *Anderson Lumber Company, supra,* makes clear that any knowledge must be brought home to the directing mind and will of the third party corporation. However, having found no knowledge, I need not pursue this argument to a final determination. Billes was a director of Newmat, but not an officer and not part of management. As it relates to the Trust, while I have found her in *de facto* control for decision making purposes, the Trust could

only execute a Loan by a majority of its trustees, and she was only one of three separate legal entities (trustees) who constituted the Trust.

[474] I accept the submissions of Billes that, in the negotiation of the Newmat Loan, Newmat was represented by Newel who consulted with Matkaluk, both of whom were directors and officers of Newmat. For the purposes of this transaction, Newel, the Chief Financial Officer of Newmat, and the Newmat officer most active in the business dealings of Newmat, was the directing mind of Newmat. Accordingly, I find that he was the person providing instructions for Newmat, although Billes and Lavery, on her behalf, were also in communication with Marshall. Even there, however, I find, as Lavery corroborated, that Billes left the final decisions to Newel, stating that she was "washing her hands" of it. There is nothing in the evidence to suggest that either Newal or Lavery knew of any difficulty with the making of the Newmat Loan, or even that there was a USA among DDL's shareholders. Indeed, I find that Newel was unaware of Mason's interest and believed DDL was owned 50/50 by Billes and McAteer. As such, Newmat could not be said to have had knowledge of the breach.

[475] In relation to the Trust, Billes was only one of three Trustees and she had no beneficial interest in the Trust. I note that, while Billes did not have legal control of the Trust, I have found that she did have *de facto* control, in that neither of Lavery nor Mann would vote against her view, unless there was any illegality. However, I find that neither Lavery nor Mann were aware of Billes' breach of her disclosure obligations to DDL. Moreover, McAteer represented to Whitlock, at the beginning of the discussions regarding the Trust Loan, that DDL was solely owned by McAteer (39 1/3% for his children) and Billes (Exhibit 471), although, of course this was not true. I find that Billes did not know that McAteer had not complied with the requirements on her behalf. As a result, the Trust had insufficient knowledge, constructive or actual, to become constructive trustees.

[476] In the result, the Loans and the security therefor were valid and enforceable. In other words, as third parties dealing in good faith with the directors of DDL, and without knowledge of irregularity, they were entitled to assume that the internal steps requisite for the formal validity of the directors' acts had been duly carried out: *Rolled Steel Products, supra*.

[477] Mason acknowledged the *Breckenridge* principle (see: *Communities Economic Development Fund* v. *Canadian Pickles Corp.*, [1991] 3 S.C.R. 388) which states that a debtor, even if a transaction is a nullity, has no answer to an action for money had and received, as it has a legal obligation to repay the funds received. Nonetheless, Mason attempted to distinguish that decision on the basis that there were no other creditors in that case - a distinction that does not follow from a review of the reasoning of Iacobucci J., at 213 *et seq*.

[478] Mason points out, however, that even if the Trust Loan and the Trust debenture were set aside, the Trust would still have a claim against DDL for monies had and received, although it could lose its status as a "secured creditor".

[479] Billes *et al.*. argued that, even if shareholder approval was not obtained, the statutory "indoor management" rule applies. I have applied that rule in favour of the Lenders, because of their lack of knowledge of irregularity.

[480] Further, the Loan transactions, although in excess of DDL's power due to the lack of internal compliance, were not *ultra vires*. That is, they would not have been beyond DDL's capacity if there had been proper internal compliance. McAteer summarized this distinction, relying (as did Mason) on *Rolled Steel*, in this fashion:

> Browne-Wilkinson L. J., discussed the use of the phrase *"ultra vires"* which literally means beyond the powers. He discusses the use of the phrase and how it has been used interchangeably in reference to the objects of a corporation and the powers to carry out those objects. He distinguishes the dual use of the phrase and limits the use of the phrase to the situation where a corporation has violated the articles or objects of the corporation and is beyond the capacity of the corporation and therefore wholly void.

[481] Consequently, the Loans and their security are not void on those grounds. Given my finding that Newmat and the Trust did not have notice of the irregularities regarding the internal approval of the Loans, and that the transactions were fully executed prior to any knowledge on Mason's part, she is only entitled to hold liable the parties who carried out the transactions, namely McAteer and Billes. See *Rolled Steel*, at 88, 91-92, which states:

> ... it is clear that a transaction falling within the objects of the company is capable of conferring rights on third parties even though the transaction was an abuse of the powers of the company: see e.g. *Re David Payne & Co. Ltd.* [1904] 2 Ch. 608. It is therefore established that a company has capacity to carry out a transaction which falls within its objects even though carried out by the wrongful exercise of its powers.
>
> ... If two trustees convey trust property in breach of trust, the conveyance is not void. ... Even if their powers under the trust instrument did not authorize the conveyance, the legal estate will vest in the transferee. ... If the beneficiaries only discovered the position after the conveyance, the transferee, if he took with notice, would be personally liable as a constructive trustee and the property conveyed could be recovered: but the conveyance would not be a nullity. So in the case of a limited company, if a transaction falls within the objects of the company (and is therefore within its capacity), it is effective to vest rights in a third party even if the transaction was carried out in excess or abuse of the powers of the company. If the *members of the company* ... only discover the facts later, *their remedy lies against those who have wrongly caused the company to act in excess or abuse of the company's powers*....: see *Belmont Finance Corporation Ltd. v. Williams Furniture Ltd. (No. 2)*, [1980] 1 All E.R. 393....

> ... the principles of ostensible authority apply to the acts of directors acting as agents of the company and the rule in *Royal British Bank* v. *Turquand* (1856), 6 E. & B. 327, [1843-60] All E.R. Rep. 435 establishes that a third party dealing in good faith with directors is entitled to assume that the internal steps requisite for the formal validity of the directors' acts have been duly carried through. If, however, the third party has actual or constructive notice that such steps had not been taken, he will not be able to rely on any ostensible authority of the directors and their acts, being in excess of their actual authority, will not be the acts of the company.
>
> The critical distinction is, therefore, between acts done in excess of the capacity of the company on the one hand and acts done in excess or abuse of the powers of the company on the other. If the transaction is beyond the capacity of the company it is in any event a nullity and wholly void: whether or not the third party had notice of the invalidity, property transferred or money paid under such a transaction will be recoverable from the third party. If, on the other hand, the transaction (although in excess or abuse of powers) is within the capacity of the company, the position of the third party depends upon whether or not he had notice that the transaction was in excess or abuse of the powers of the company. *As between the shareholders and the directors*, for most purposes it makes no practical difference whether the transaction is beyond the capacity of the company or merely in excess or abuse of its power: in either event *the shareholders will be able to ... hold liable those who have carried it out*.... [Emphasis added.]

[482] Billes argued that the *Rolled Steel* case is distinguishable, because the Court found actual knowledge of lack of authority. That may well be the factual case, contrary to what I find here, but it does not affect the application of its principles to this case. Billes also argued that the “Trust and Newmat are not persons who have or ought to have by virtue of a position with or relationship to DDL knowledge of any alleged non-compliance with a USA”. I agree with this later submission on my findings.

[483] Billes also argued, relying on *ABC Colour & Sound Ltd.* v. *Royal Bank of Canada* (1988), 70 C.B.R. (N.S.) 251 (Alta. Q.B.), aff’d (1991), 117 A.R. 271 (C.A.) that, even if a constructive trust were found to exist, there was an issue as to what assets would be caught by the constructive trust. She argued that, except for HAL, DDL had no assets, and the hard assets were all in the Kingswood Entities, but, due to the security, there was no equity left. Accordingly, she argued that DDL and the Kingswood Entities were insolvent, and accordingly had not suffered a loss. I can put this argument quickly to bed because I have found that none of the Lenders or their Counsel had knowledge of Billes’ breach of her duty to DDL and Mason. Moreover, I have upheld the Loans and found that the processes of execution on the security were not unreasonable, and finally, I have granted Mason a remedy under the oppression provisions.

[484] Accordingly, there is no additional relief to be granted under the constructive trust doctrine.

3. Breach of Fiduciary Duty

[485] Mason argued that Billes and McAteer, in their capacity as a directors, owed Mason a fiduciary duty as a shareholder. Mason relied on *Hodgkinson* v. *Simms*, [1994] 3 S.C.R. 377 and *Frame* v. *Smith*, [1987] 2 S.C.R. 99, as setting out the general characteristics of a fiduciary relationship.

[486] In my view the law has not yet reached a point where directorship necessarily entails such a duty towards a shareholder. I acknowledge, however, that there may be exceptional circumstances where this conclusion would not apply: *Colborne* (Q/B.), *supra: McKinlay Transport Ltd.* v. *Motor Transport Industrial Relations Bureau of Ontario (Inc.)* (1996), 96 C.L.L.C. 210 (Ont. Gen. Div. - Lane J.); Ellis, *Corporate Commercial Fiduciary Duties, supra*, at 15-25, 28; and *Budd* v. *Gentra, supra*.

[487] Mason argued that such circumstances did exist in the present case. Specifically, she referenced the conversation that she, McAteer and Billes had on October 26, 1990, shortly after the revelation of the McAteer/Billes affair on October 23, 1990, (referenced in her October 12, 1992 letter to McAteer - Exhibit 137). In that conversation all three agreed that the Mason/McAteer children would not suffer. Mason submitted that this created a fiduciary relationship between McAteer and Billes to her *vis-à-vis* the Mason/McAteer children. Specifically, Mason argued that:

> ... in the circumstances of this case both Billes and McAteer undertook to act in the best interests of the McAteer Children and therefore were in a fiduciary relationship with Mason who was the trustee for their interests in DDL.

Mason completed the argument by alleging that Billes and McAteer had breached their fiduciary duties to DDL and Mason in several respects, and as a consequence DDL and Mason were entitled to damages on a restitutionary basis.

[488] In my view, the nature of that conversation was that McAteer, Mason and Billes would ensure that the children would not be unduly hurt as a result of Billes' and McAteer's extramarital affair and the breakdown of McAteer and Mason's marriage. Notwithstanding that the word "business" was included in the confirmatory answer to which Billes responded on cross, I find that those representations did not relate to Billes' investment in or the operation of DDL. In that regard, even Mason described it in these words:

> And in the beginning, I think there was every effort made by all three of us that we would *try and make this divorce as amicable as we possibly could and that the children would be hurt as little as possible by the fact that we were divorcing.* [Emphasis added]

I find that this understanding, and indeed agreement, did not create a fiduciary relationship between Billes and McAteer as directors on the one hand and Mason as a shareholder on the other.

[489] I find further that it is unnecessary for me to determine whether there were any other circumstances in the present case that gave rise to a fiduciary relationship between Billes and McAteer *vis-a-vis* Mason. It is clear that there is a close relationship between fiduciary duty and oppression in that, where a breach of a fiduciary duty has occurred, the test for oppression will also have been met: *Calmont* v. *Kredl* (1993), 142 A.R. 81 (Q,B.), aff'd (1995) 165 A.R. 81 (C.A.), *Mikulak,* relying on *Clarke* v. *Rossburger, supra*. As I have already found that an oppression remedy is appropriate in the circumstances, in relation to Mason, there is no need to provide an alternate source of relief under the guise of a fiduciary duty.

[490] Moreover, speaking in the context of fiduciary duties of directors or majority shareholders *vis-a-vis* minority shareholders, the Ontario Court of Appeal in *Brant* v. *KeepRite, supra*, at 172, discussed the important policy considerations militating against expanding fiduciary duties in a corporate context:

> The enactment of [the oppression] provisions has rendered any argument for a broadening of the categories of fiduciary relationships into the corporate context unnecessary and in my view, inappropriate.
>
> It must be recalled that in dealing with s. 234, the impugned acts, the results of the impugned acts, the protected groups, and the powers of the court to grant remedies are all extremely broad. To import the concept of breach of fiduciary duty into that statutory provision would not only complicate its interpretation and application, but could be inimical to the statutory fiduciary duty imposed upon directors in s. 117(1) (now s. 122(1)) of the CBCA.

In my view those comments apply with equal force to the current context, in the sense that adding a layer of fiduciary duty to the duty to act fairly would unnecessarily complicate matters, particularly where the oppression remedy alone provides adequate relief.

[491] Mason argued further that Billes owed her a fiduciary duty in Billes' capacity as a creditor. I my view fiduciary obligations will arise between creditors and lenders dealing at arms length only in rare circumstances. In this regard Mason argued:

> It is rare in the context of an arms-length commercial transactions that there is a finding of a fiduciary relationship between a bank and its customers. However, in special circumstances fiduciary relationships can be found. The onus of proof lies on the customer who alleges that in any individual case the line has been crossed and a fiduciary relationship has arisen.

[492] In making this argument, Mason referenced *C.I.B.C.* v. *De-Jai Holdings Inc.*, *supra* where the Court refers to, *inter alia*, J.F. Varley, "Fiduciary Responsibility of Lenders", published in

L.S.U.C., *Lender Liability and Responsibility* (November 3, 1989) at p. C-7 (see also Ellis, at 7-2.1 to 7.2.2(1)), where the author stated:

> The lender should be seen to have assumed a particular responsibility beyond what one might expect in the ordinary course of a lender-borrower relationship.
>
> ...
>
> Lender involvement in management of the borrowers' business, as sometimes practised by "venture capitalists", "merchants bankers" can similarly be seen as an assumption of a particular responsibility beyond the scope of the ordinary lender role, especially if shares or board seats are taken, or if the lender begins to deal directly with the lender's employees or suppliers on matters of management (not lender) responsibility.

The Court observed:

> The above noted comments are, in my view, of assistance in determining whether a fiduciary relationship exists in the circumstances of this case. They indicate that it is necessary to examine the relationship between the parties before examining the conduct that it is alleged gives rise to a breach of duty, in determining whether a fiduciary relationship exists.

[493] Billes countered by arguing that there was nothing on the facts of the present case to give rise to the unusual and extraordinary situation where the Lenders might be fiduciary to their borrower, DDL. I agree.

[494] As to Billes *vis-à-vis* DDL, I note that, in discovery, Billes acknowledged that she was a venture capitalist, and I find in this case that the above description is, generally, applicable to Billes. However, Billes was not a Lender in the Newmat Loan, and not a “beneficial” Lender - that is, she was a Lender in name only (as a Trustee) - in the Trust Loan. In any event, having found that Mason is entitled to an oppression remedy, I need not pursue this issue any further.

[495] As I have held *supra*, in the context of a “financial partner”, although there may have been some reliance by Mason and McAteer on Billes to find financing in order to allow DDL to continue to carry on business, there was no agreement or undertaking by Billes to that effect. Further, Mason stated that she was unaware that the Lenders were connected to Billes. Clearly if Mason was unaware of Billes’ conflict of interest she could not have expected Newmat and the Trust to set aside their own self interests for the sake of DDL, particularly given that the Loans were structured as demand loans.

[496] Mason also argued that Newmat and the Trust ought to be held to be in fiduciary positions as she alleges that they acted in association with Billes in the breach of her duty. In that regard

she relied on *Canada Safeway Ltd.* v. *Thompson*, [1952] 2 D.L.R. 591 (B.C.S.C.). Mason put it in these words:

> ...Newmat, the Estate Trust and Owen Billes, while not in a fiduciary position themselves to Mason, may be caught in the circumstances of this case by the fiduciary duties owed to DDL and Mason by Billes in that they acted in association with Billes in the purported enforcement of the securities and with the knowledge that Billes was in breach of her duty to DDL and Mason.

However, the argument fails as I have found that Billes was unaware of her failure to disclose in that she was relying on McAteer in that regard. The evidence leads me to conclude that those entities continued to lack such knowledge until after the Loans were in default, and the only option seemed to be enforcement.

[497] Mason argued further that McAteer has also breached his fiduciary duties in failing to make prudent business decisions and failing to advise of Billes' conflict of interest. With respect to allegations regarding prudent investments, in my view that is a business judgement, and although it is reviewable, the Courts have been loathe to substitute their own opinions for that of the directors: *Brant Investments* v. *KeepRite Inc, supra*; *CW Shareholdings Inc.* v. *WIC Western International Communications Ltd.* (1998), 39 OR. (3d) 755 (C.A); D. Peterson *Shareholders Remedies in Canada* at para. 8.20.1), so long as they are acting in the best interests of the company: *Re Smith and Fawcett Ltd.*, [1942] Ch. 304 (C.A.); *Cramer* v. *General Telephone & Electronics Corp*. 582 F.2d 259 (3rd Cir.1978); and *Burland* v. *Earle*, [1902] A.C. 83 (P.C.); *Teck Corp. Ltd., supra.* In other words, "the court looks to see that the directors made a reasonable decision not a perfect decision": *Pente Investment Management Ltd.* v. *Schneider Corp.* (1998), 42 O.R. (3d) 177 (C.A.), aff'g (1998), 40 B.L.R.(2d) 244 (Ont. Gen. Div.).

[498] This is not a case in which the Court's further involvement under a fiduciary duty remedy is appropriate. However, McAteer's knowledge of Billes' conflict and his failure to disclose it, knowing the impact it would have on Mason, is enough for me to find him jointly and severally liable with Billes, under the oppression remedy, as I have done.

[499] There were considerable further arguments (pro and con) in relation to fiduciary duties and damages to Mason. However, having found Mason entitled to damages under the oppression remedy, I find that I do not need to consider any other independent remedy based on breach of fiduciary duty.

I. Relief to Mason

1. Declarations

[500] Mason, in the Mason/McAteer Action, is entitled to a declaration that McAteer and Billes have conducted themselves as directors and shareholders in DDL in a manner that was unfairly prejudicial to and which unfairly disregarded Mason's interests.

2. Damages

[501] As a remedy, Mason focussed on damages in the amount of the equivalent of the value of Mason’s shares at the time of the oppressive conduct. In this regard, Mason argued:

> D. Peterson in *Shareholder Remedies in Canada* reviews the orders available to remedy oppressive actions in c. 18. Peterson discusses the order directing a purchase of security at paragraphs 18.175 through 18.197.1 of c. 18. He also discusses the order compensating an "aggrieved person" at paragraphs 18.208 through 18.227.
>
> Under s. 234(3)(g) of the Alberta *Business Corporations Act*, the Court is empowered to make "an order directing a corporation…….or any other person, to purchase securities of a security holder".... D. Peterson points out that no specific guidelines have been provided for the valuation of shares. However, two general principles have emerged with respect to the valuation methodology under the oppression remedy. The first is that *the shares of the minority are to be valued as if the oppressive conduct did not occur*, if the circumstances are appropriate. The second principle is that *the shares are to be priced at "fair value"*. Further, *where the oppressive conduct has reduced the value* of the corporation, the general rule is that the valuation date is the date on which the application was commenced.
>
> At para. 18.178 and 18.179, D. Peterson points out that the cases suggest that there are at least four *circumstances where the courts will order a purchase of shares. The first circumstance is where majority shareholder abuse leaves no meaningful opportunity for involvement by the oppressed party*. D. Peterson cites *Scottish Co-operative Wholesale Society Ltd.* v. *Meyer* as an example. In that case the oppressive conduct resulted in the destruction of the company. *Without a viable going concern, the only alternative was to order the majority to purchase the shares of the minority at the price they would have been worth if the oppressive conduct had not occurred*. [Emphasis of Mason removed, and new emphasis added.]

[502] On the issue of valuation date, Mason went on to argue:

> D. Prentice in an article entitled "Minority Shareholder Oppression: Valuation of Shares" (1986) 102 Law Q.Rev. 179 discusses a number of decisions dealing with the principles to be adopted in valuing shares pursuant to an order of purchase. At p. 184, he writes:
>
> > "…..The other issue of importance dealt with in recent cases is *the date on which the valuation should be taken* to have been made. For example, should it be at *the*

> *date the oppression occurs*, the date of the petition, the date of judgment, or at some other date? Keeping in mind the general principle that *the oppression should not be allowed to affect the value of the shares*, the following principles can be culled from the cases. First, if there is any "such a thing as a general rule" then the "date of the order or the actual valuation would be more appropriate than the date of the presentation of the petition or the unfair prejudice" (*Re London School of Electronics Ltd.*, [1985] 3 W.L.R. 474, 484B). The reason for this being that an interest in a going concern ought normally to be valued at the date of the purchase order. However, as Nourse J. pointed out in *Re London School of Electronics Ltd.*, the overriding requirement of fairness may make this rule subject to so many exceptions that the exceptions will gobble up the rule: in fact *the first general principle may be that there is no general principle*.
>
> Second, the valuation date should not (a) deprive the petitioner of the benefits of any contributions he has made to the business success of the company, or (b) confer on the petitioner the benefits of contributions to the company's business for which he has not been responsible. Both of these principles are implicit in *Re London School of Electronics Ltd.* (see also *Re O.C. (Transport) Services Ltd.* [1984] B.C.L.C. 251)...." [Emphasis added.]

[503] Mason relied on *Hodgkinson* v. *Simms*, *supra* with regard to the law relating to the calculation of damages in the context of breach of fiduciary duty. She also relied on the cases cited therein, specifically *London Loan & Savings Co.* v. *Brickendon,* [1934] 3 D.L.R. 465 (P.C.), and *Commerce Capital Trust Co.* v. *Berk, supra,* for the proposition that (*Hodgkinson* v. *Simms, supra* at 441) “once the plaintiff has made out its case for non-disclosure and the loss occasioned thereby the onus is on the defendant to prove that the innocent victim would have suffered the same loss regardless of the breach”.

[504] Based on these and other submissions on the law, Mason finally argued:

> Applying the principles set forth above to the facts of the present case, it is respectfully submitted that Mason should be compensated for the loss in value of the shares she held in DDL which was caused by the oppressive conduct of Billes and McAteer. The evidence of Siebert, which is to be preferred in this matter, indicates a "fair value" of the shares in the range of $440,000.00 to $600,000.00 as at February-March, 1991, being the date when the oppressive conduct of Billes and McAteer commenced. At the present time the shares of DDL are worthless since the oppressive conduct of Billes and McAteer resulted in the destruction of the company.

[505] In my view damages to Mason in the amount of the value of her shares at the time the oppressive conduct occurred, March 21, 1991, are appropriate. Such an order is appropriately made under s.234(3)(l) as an order compensating an aggrieved person. An order that McAteer and Billes purchase Mason’s shares in DDL at a valuation date just prior to the oppression

under s.234(3)(g) would yield the same result, but it would be an unnecessary fiction given that DDL is now defunct.

a. Fair Value

[506] There was significant argument on what the fair value of the Mason shares was at the time I found the oppressive conduct to have commenced, being the time of the Trust Loan on March 21, 1991. Lorne Siebert ("Siebert") (called by Mason) and Jeffrey Cristall ("Cristall") (called by Billes), each Chartered Business Valuators, gave expert comments and opinions relevant to that matter. While sidetracked on arguments of definition and methods of assessing fair market value, the issue between them essentially boiled down to determining whether the purchase by Billes of a 50% interest in DDL in April 1990 was an indication of the fair value of the shares at that time and ten or eleven months later. Billes argued that Siebert's methodology departed from standard writings on the subject and was not an indication of fair value, but rather that the value, based on Cristall's opinion was nil.

[507] The evidence of the experts, Siebert and Cristall, and the other experts who provided a basis for their analysis in their expert reports and testimony, was detailed and technical. In providing a basis as to how I arrived at my conclusion regarding valuation, I believe that I can do no better than to repeat some of the evidence that was given and arguments that were made and provide my comments thereon.

i. Siebert's Evidence

[508] Siebert's primary report (Exhibit 351) relied upon the analysis of Derek Malcolm ("Malcolm"), a Chartered Accountant with expertise in forensic and investigative accounting. Malcolm was engaged to identify, analyse and summarize various documents to provide a historical basis for valuation of DDL and, as relevant, the Kingswood Entities, and prepare a report (Exhibit 333) in that regard. Siebert also prepared a rebuttal report (Exhibit 352) in response to Cristall's report (Exhibit 393), and in oral evidence commented on Cristall's rebuttal report (Exhibit 394).

[509] In arriving at the value of the DDL shares at April, 1990 and March, 1991, Siebert used (para. 1.4 of Exhibit 351) the following definition of "fair market value": "the highest price available in an open and unrestricted market between informed and prudent parties, acting at arms length and under no compulsion to transact, expressed in terms of monies worth". While there was much cross and argument about this definition, I find that it is precisely the definition used by all the learned authors referenced, including: R.M. Wise, J.E. Fishman and S.P. Pratt, *Guide to Canadian Business Valuations*, (Looseleaf), Volume 1 (Toronto: Carswell, 2000)(Exhibits 353 and 397 - para. 205.03); and D. Peterson, *Shareholder Remedies in Canada, supra*, c. 4). See also: *Mackenzie Financial Corp.* v. *McRae* (1998), 81 O.T.C. 321 at para. 130

et seq, (Gen. Div.), referenced in *36941 Alberta Ltd.* v. *Pocklington* (2000), 271 A.R. 280 at para. 84 (C.A.). Moreover, except for the qualifying “factors”, Siebert’s definition is not inconsistent with the definition in article 1.01(h) of the USA (Exhibit 13), to which the parties agreed. Cristall also used this definition (Exhibit 393), except he added the word “equally” before “informed”, a modifier that I find inconsistent with the accepted definition and invalid. Nonetheless, Cristall claimed that removing that qualifier did not really affect his opinion. As such, I find that there is little need for further debate on the subject, aside from some comments on the issue of “equally”. I would , however, point out that, for the oppression remedy, the operative consideration is “fair value”, not “fair market value”.

[510] In short, Siebert concluded, using the market comparable approach, that the *en bloc* value of DDL at April, 1990 was $1,500,000.00 making Mason's 40% interest worth approximately $600,000.00. In arriving at that conclusion Siebert was cognizant of the Billes acquisition of 50% of DDL shares and was of the view that that transaction met all of the factors involved in the definition of fair market value.

[511] In addition, Siebert looked at other transactions that took place at or around that time and indicated they supported his view of the value of 100% of the shares of DDL at April 30, 1990. These transactions included the Murray transaction (Transcript 1235 *et seq.*), the McLarty transaction and McAteer's view as to the value of DDL shares in the Separation Agreement between McAteer and Mason. He also looked at the H & T Enns Holdings Ltd., the Curtises, the Smirnovs and WC Enterprises transactions and stated, in chief:

> In each of these transactions -- and they were all buying minority interests in the Golf LP .... So here we have other parties buying into the golf course believing that there's [$1,000,000] worth of value in that golf course....
>
> ...
>
> And if you look at all these transactions ... it is my view that the best evidence is the transaction where Billes purchased 50 percent of the shares of DDL for $750,000 for the equivalent of [$1,500,000] for the value of the DDL shares.
>
> But the other transactions suggest that other people believe there was value in DDL, in its assets, in its prospects in the future. And not that all the values exactly line up; but they all suggest that various parties believe that there was value in this enterprise, in this project if you will, this vision of McAteer.

[512] He was then asked about the value of 100% percent of the shares of DDL at March 21, 1991. He stated that, in his opinion, there would not have been any significant or material change from the $1,500,000 value just ten months earlier. He based his opinion in that respect on:

(a) no significant change in the nature of DDL's business as it was still in the real estate development and golf course business;
(b) plans that DDL had in place in April, 1990 had been executed, including the Murray buyout, the Phase II land acquisition, and the sale of an interest in the golf course to the Curtises;
(c) lot sales continued at approximately the same rate as DDL had enjoyed in April of 1990;
(d) the financial position of DDL had not changed materially;
(e) DDL was able to attract additional capital (the Trust loan) - Siebert theorized that nobody would put money into DDL unless they believed in DDL's future prospects;
(f) the long term nature of the investment - the shareholders were aware there would be no positive cash flow from the Kingswood project until approximately the fall of 1993; and
(g) the Separation Agreement between Mason and McAteer (Exhibit 28) would indicate they believed the *en bloc* value of DDL was in excess of $1.5 million [the children’s 40% share holding was indicated to be worth approximately $775,000].

[513] In relation to the last point, I would not have put any weight on the values used in the Separation Agreement as they do not reflect arms length transactions. With that exception, I find the above analysis supportive of Siebert’s conclusion as to fair market value as at March 21, 1991. I would again point out, however, that for the oppression remedy, the operative consideration is “fair value”, not “fair market value”.

ii. Cristall’s Evidence

[514] Siebert and Cristall agreed that there was no material change in the value of the shares of DDL between April 23, 1990 and March 21, 1991. The difference between Siebert's and Cristall's Reports was primarily in the different view they took of the value of the DDL shares at April 23, 1990.

[515] Billes summarized Cristall’s evidence at length. In the next section I will refer to that argument extensively, interjecting where I disagree.

[516] Cristall opined that the net asset approach to going concern value was appropriate for DDL, as it was a real estate development company with no history of earnings. This is consistent with Exhibit 353. He also gave evidence that it was not necessary to obtain a valuation of each property as a valuator in the exercise of his professional judgement may rely upon other evidence.

[517] Cristall's report stated (Exhibit 393) that DDL had a value of nil on November 27, 1992. Although this nil value might well have been the case on a net basis, after the Trust and Newmat Loans were added to the liability side of the financial statements, that was not even the view of Sali, Counsel for Billes, at that time. Here we see Billes argue that there was no value to the 50% shareholding she acquired in 1990, yet when matters were in dire straits in October 1992, Counsel on her behalf was still proposing a value of those shares of $500,000 (Exhibit 119a and 128).

Surely this is not indicative of no value in early 1991, before $3.3 million in debt was added. This demonstrates the incredulity of the Cristall opinion.

[518] Cristall provided valuation opinions for April 23, 1990 and March 23, 1991 (Exhibit 394), concluding that the value of DDL on those dates was nil. Those opinions were based on independent appraisals or other evidence of valuation.

iii. Arguments and Analysis

[519] I do not accept Cristall’s opinion, and find it preposterous that Billes, a sophisticated business person with professional advice, would invest $750,000 to buy 50% of a company that was worth nothing. I also come to that conclusion after an analysis of the numerous arguments on the subject.

[520] Billes, however, argued:

> Cristall gave evidence with respect to the assessment of the various transactions of 1990 (Murray, Smirnov, Curtis) which were suggested by Siebert to be relevant. He testified that such transactions would require adjustment or investigation to insure that they were on the basis of money or money's worth. He noted that a number of the transactions (Murray, Smirnov, Curtis) were not money or money's worth, but had significant non-cash components.
>
> Cristall gave evidence with respect to the market comparable analysis. In that regard, Mr. Campbell's authoritative commentary was substantiated by Cristall. The commentary is set out in Exhibit 354, and reiterates the basic propositions in a market comparable approach that there must be a sufficient number of transactions and the details of the transactions must be sufficiently known, in order for one to come to a reasoned decision as to whether the prices of the transactions are comparable and can be used to yield a value.

[521] While the details of the transaction need to be known, as is the case here, the theory requiring a “sufficient number of transactions” applies when there are no valid “actual sales” of the subject shares and one must look at other sales surrogates to provide a notional market value opinion. When there is an “actual sale”, as in the sale of shares to Billes, and it is a valid indicator, and I accept that it is, I am of the view that numerous transactions are not required. Only one is required if it meets the definition and is an “actual sale”.

[522] Billes then argued:

> Cristall testified that there is a difference between price and value, and that in assessing value, one must make certain assumptions with respect to the attributes and motivations of the buyer and seller. These attributes are set out in the

> definition of fair market value, and Cristall testified that, although his wording was slightly different and was developed by him, it had the same meaning.
>
> Cristall testified that part of the attributes of the willing buyer and willing seller are that they are acting prudently and are *equally informed*. Cristall testified that, in his view, the requirements for prudence were not met and that a buyer and seller would have obtained more information in the due diligence process. [Emphasis added.]

[523] I do not accept his conclusion about being “equally” informed. As I have noted above, it is inconsistent with other acceptable definitions for fair market value, including the one used by Cooke, for his fair market value analysis (Exhibits 386, 388 and 389). I find that Billes, in the purchase of 50% of DDL was “acting prudently”, and “knowledgeably”, but obviously could not be as “equally informed” as the vendors.

[524] Billes submitted further that, although Siebert selected the "comparative" approach and characterized the Billes purchase of a minority interest as a cash transaction and as a market comparable for the *en bloc* value of DDL, he did not provide an opinion of value.

[525] That argument is confusing, because, while *Siebert did not calculate a value*, he testified that *the value paid by Billes was indicative of fair market value* in his opinion. In this regard he said: “I understand what the transaction value was; and ...it is my opinion that that is indicative of what the fair market value was.”

[526] Billes contended as well that Siebert's methodology departed from the standard writings on the subject and that fair market value is an assessment in a notional market place. She stated that it involves hypothetical buyers and hypothetical sellers and that this point was made by Cristall, and is found in the independent literature (Exhibit 353, extract from *Wise et al., Canadian Valuation Service*, at para. 205.03).

[527] This is similar to the point above - while fair market value may include “an assessment in a notional market place”, it need not be tied to a notional market when, in circumstances such as this, there is an actual sale of the asset in question at the subject time. The requirement is, thus, not a “notional market”, but rather a sale (in this case an actual sale) within the definition of true market value.

[528] Similarly, Billes stated:

> Value and price are not the same concepts. Prices arise from recent sales. Sometimes value of comparable interests can be estimated from analyzing those sale prices. That is the market concept. It is described in Exhibit 253, para. 215.04.

[529] I agree with the first proposition. I also agree with the second, where there is a need for comparative analysis of unrelated sales, which, when utilized, is in accord with the third proposition. However on the same point as above and at the risk of repetition, I find that comparative analysis of unrelated sales is unnecessary if there is, as in this case, a valid actual market value sale of the subject asset. To conclude on this issue, if buyer A comes within the definition of "fair market value" and pays $x for an asset on day y, and buyer B wants to obtain an opinion on the value of the asset as at day y, one would rightfully conclude that the value was $x, without enquiring as to the value others paid for different, but similar, assets at other times.

[530] Later, on a more specific analysis, Billes argued that:

> Siebert described the market comparable approach in para. 4.4 of his report (Exhibit 351), stating that it was appropriate where recent "transactions" (plural) to buy and sell the shares of a company or a closely-comparable company can be identified and there is sufficient evidence to suggest that these "transactions" (plural) are representative of *en bloc* fair market value.

While *more than one sale of the subject assets would provide greater confidence*, I find that *more than one valid "actual sale" is not required*, if the one in question is a true indication of fair market value.

[531] The Billes argument continued:

> In Exhibit 351, Siebert expressed his beliefs (not opinions) as to the *en bloc* fair market value based on the market comparable approach to valuation (Exhibit 351, paras. 5.4 and 5.5).
>
> ... when one considers what Siebert actually did, he did not employ the market comparable approach. A single transaction does not qualify as a market comparable. A single transaction for a minority interest is not a market comparable for the *en bloc* interest.

[532] I have commented on the argument between a calculated opinion on value and Siebert's expression of value, which I find to be, in law, an opinion none-the-less. While what Siebert opined on may not be the "market comparable approach" in the sense that it is not based on other external comparable sales, it is expert evidence of fair market value of these shares which I accept in its conclusion.

[533] The Billes argument continued:

> Moreover, the Billes purchase contained a significant non-cash component (the services of McAteer). This was not a clean purchase of shares for cash. It was a part of an agreement which contained non-cash elements (Exhibit 12A).

Again, I disagree. It was for cash, but the services of McAteer merely added unquantified value to the shares.

[534] Billes continued:

> Siebert admitted he did not have sufficient information to quantify the value of McAteer's services (Siebert, 1303 - 1307). His assumption that the vast majority of the deal was a cash transaction (Siebert, 1307), is inconsistent with the evidence of Lavery and of Billes (paras. 104,114 *supra*).

Again, I do not agree. While Siebert may not have been able to quantify the value of McAteer’s services, that does not mean that they did not add value to DDL, as the evidence of Lavery and Billes suggest. Nevertheless, that, in my view, does not detract from true market value. However, this merits further comment.

[535] The fact that much faith and value was placed upon McAteer as a key person, or that he was prepared to work with a draw from his shareholders loan, with little or no additional compensation, does not, in my view, adversely affect market value - indeed, it enhanced it. As Lavery acknowledged when he testified:

> As part of the proposal, McAteer in effect agreed to work for nothing for several years .... it basically gave Billes his services for a couple of years, which, given any sort of reasonable compensation for an executive of his experience, had some significant value.

[536] These factors, in my view, went to the goodwill of DDL, such that its value may have been more than the sum of the value of its physical assets. It also includes the goodwill in McAteer’s participation and his vision of the development. The fact that McAteer was taking little salary, and receiving compensation through the repayment of shareholders’ loans is not a negative impact on the value in my view.

[537] The argument of Billes again continued:

> It is notable that McAteer, the most informed of all the parties on April 23, 1990, agreed to sell his 10% interest for the least amount. He received $50,000, and in light of the significant non-cash components pursuant to Exhibit 12A, the amount for which he actually sold his shares was likely significantly less.
>
> Further, if Siebert's comments were to be used to gauge any alleged loss by Mason, it must be remembered that she claims as trustee for the 40% shareholders (the children). There was no transaction for their shares on April 23, 1990. The value of their shares falls to be determined within the hypothetical market place and, Siebert made no analysis of any discounts for minority interest or for illiquidity in the shares arising from the provisions of the USA.

I interrupt the argument again to find Billes' share purchase was not in a "hypothetical market place"; rather, it was the actual acquisition of a 50% share interest in DDL. As to the discounts, I agree, but no expert, including Cristall, provided any analysis on an appropriate discount.

[538] Billes' also highlighted Cristall's point in his rebuttal report (Exhibit 394), that the buyers did not appear to have done sufficient due diligence. Cristall's opinion was that it was imprudent to rely upon the outdated appraisals and unsubstantiated management information which is found in Exhibit 10. He testified that the forecasts prepared by management in Exhibit 10 were aggressive.

[539] Billes also noted that Cristall has carried on most of his valuation career in the Province of Manitoba and had experience at the time with golf course projects in Manitoba. She noted that Siebert does not share those qualifications.

[540] While Cristall is from Manitoba and the knowledge of the local situation is valuable, he was qualified as a chartered valuator, as was Siebert. I do not find that the fact that Siebert had not practised as a business valuator in Manitoba and had not valued golf courses in Manitoba diminishes his opinion. Neither he nor Cristall, were qualified as experts on the value of Manitoba golf courses or their shares.

[541] Moreover, I do not accept Cristall's analysis of the due diligence, but that merits some further observations. Due diligence, like an opinion of value, is a reasonable and informed view on the available information; it is not perfection.

[542] The fact that Lavery, who provided the due diligence, was not a business valuator is not conclusive. He was (as he confirmed in testimony) Billes' business advisor, as well as the engagement partner at Deloitte responsible for DDL, and if she needed more advice or information, he was exactly the person to get it for her. He did not consider it necessary. Mason put it this way in argument:

> Lavery was more than merely a "tax partner" at Deloitte & Touche. Lavery was a business advisor for Billes as well as the engagement partner responsible for DDL, Newmat, HAL and other parties. In many respects, Lavery was the common denominator between the major witnesses in this matter - namely Billes, Newel, and McAteer.

Lavery also testified that he had experience with golf course developments in the Calgary area. While obtaining real estate appraisals might have been theoretically prudent, it was not a requirement in the circumstances, nor does it detract from the investment price being a very strong indicator of fair market value.

[543] In any event, Lavery did "due diligence" with respect to other golf course developments in Alberta, and ultimately gave Billes advice that "given the structure of the transaction that

there might be a reasonable opportunity for profit and some protection on the downside given the underlying assets".

[544] Lavery confirmed in his evidence that Billes was an experienced business person and had experience in real estate development as a result of her investment in Lands End in Saanich, B.C.

[545] The Billes argument continued:

> Cristall used an appraisal-based approach, whereas Siebert based his comments on a market comparable approach. Siebert agreed that he would get appraisals if he was doing a fair market value calculation in the absence of a transaction. As submitted above, there were not market comparables or "transactions" which is the standard expressed in his report. He purported to rely on one transaction for a minority interest. He then extrapolated to comment on the *en bloc* value of DDL. His comments are not within the parameters of his own definition.

I agree with the description of what Siebert did and said, but not on the conclusions argued.

[546] The argument continued:

> The reason why informed and prudent parties would obtain appraisals is that they also would have considered the value of this company given the stage of its development, on an asset basis.

I have already addressed this.

[547] Billes alleged a number of "additional observations" or discrepancies in Siebert's understanding of the factual base for his opinion. Based on my analysis of these allegations, I have found no real discrepancies that, on the evidence, affected his opinion. Accordingly, it would not be a valuable exercise to pursue each of these and to lay them to rest.

[548] I can stop the analysis because Billes' arguments do not adversely affect my preference for Siebert's conclusions over Cristall's. Moreover, Mason countered Billes' observations and arguments with further detailed arguments and analysis that aid me in my conclusion to accept Siebert's opinion and to reject Cristall's (see Mason's argument at p. 35 and in reply at pp. 13-14).

iv. Conclusion on Fair Value

[549] I accept the evidence of Siebert as to fair market value over that of Cristall, recognizing that my task is merely to find "fair value". In fact, except for one assumption that Cristall makes, their evidence is substantially the same. I find that the assumption made by Siebert, but rejected by Cristall, that the purchase by Billes of a 50% interest in DDL for $750,000 is a valid measure

of fair market value and should be accepted. I find further that Billes was a sophisticated investor, who had the advice of a business adviser and chartered accountant from a major chartered accounting firm, that due diligence was undertaken and that all the other tests of fair market value were met.

[550] Counsel for Mason argued that the damages based on the fair value of the shares should be in the range of $440,000 to $600,000. The final question is how does the Court determine where in that range the appropriate amount falls.

[551] In evidence and argument Siebert and Mason concentrated on the agreement between Siebert and Cristall that the value had not changed significantly between the Billes purchase and the Trust Loan. Remembering that Siebert had noted a fair market value of $600,000 as at April 1990 (Exhibit 351, para. 5.), it would follow that, if the value had not changed, it should be $600,000 at March 21, 1991. However, Mason cannot escape the expert finding of Siebert that "rolled forward ten months to adjust for lot sales and changed to individual assets and liabilities", the value would be $440,000 (Exhibit 351, para. 5.2.). Cristall supported that reduction in his testimony, although his view in that regard is contradicted by the fact that he was of the opinion that the value in each case was nil. Siebert's opinion is binding on Mason and she has not demonstrated either through oral testimony or argument any reason upon which to change that opinion.

[552] Therefore, I accept the value of $440,000 proposed by Siebert as a basis for the calculation of damages. I might well have allowed a minority discount as an adjustment, but no expert provided me with a basis upon which to make that calculation and, accordingly, I make none. Additionally, it may well have been that some of the considerations in the previous paragraph would have made a minority discount for a 40% interest minimal, and therefore it may not have been an issue of any substance.

[553] Consequently, I find damages in the amount of $440,000.00 are appropriate as representing the "fair value" of the Mason interest on March 21, 1991, at the time of McAteer's and Billes' oppressive conduct relating to the execution of the Trust Loan documentation. As her minority interest had been oppressed by conduct at the time by the Trust Loan, I find that the damage had been done prior to the Newmat Loan and therefore its operation had no additional affect on her loss. Compensating Mason for the loss in share value is the only remedy available that will place her in a position as if her interests had not been oppressed.

b. Punitive Damages

[554] Aggravated or punitive damages were sought in the prayer for relief in the Mason Action. I have granted damages under the oppression remedy in that Action. Are aggravated or punitive damages also appropriate?

[555] While Billes argued that “there are no circumstances which remotely justify an award [for aggravated or punitive damages]”, Mason argued:

> In Alberta, the rationale underlying awards of punitive damages lies with Clement, J.A.'s declaration of principle in *Paragon Properties Ltd.* v. *Magna Investments Ltd.* (1972), 24 D.L.R. (3d) 156 at 167 (Alta. S.C.A.D.):
>
> > The basis of such an award [of punitive damages] is actionable injury to the plaintiff done in such a manner that it offends the ordinary standards of morality or decent conduct in the community in such marked degree that censure by way of damages is, in the opinion of the Court, warranted. The object is variously described to include deterrence to other possible wrongdoers, or punishment for maliciousness, or supra-compensatory recognition of unnecessary humiliation or other harm to which the claimant has been subjected by the censurable act.
>
> *Paragon Properties Ltd.* v. *Manga Investments Ltd.* was decided in 1972. Clement J.A.'s remarks have since been endorsed by Wilson and McIntyre JJ. in *Vorvis* v. *I.C.B.C.,* [1989] 1 S.C.R. 1085.

[556] Having considered the circumstances of the within case, including the conduct of Billes and McAteer, I find that punitive damages are not appropriate. In my view Billes and McAteer’s conduct has been taken into account under the oppression remedy and there is nothing so egregious, despite my finding of fraud in relation to McAteer, that would justify a further award of punitive damages.

c. Flow of Damages

[557] Under s. 233(c) of the *ABCA*, I order that the damages flow directly to Mason in trust for the McAteer children.

J. Consequences to Others

1. To the Trust, Newmat and DDL

[558] I have found that the Loans were valid at the time that they were entered into. Accordingly, DDL is bound thereby.

[559] However, in the Mason Action it was alleged that the Trust and Newmat, in enforcement of their security, obtained realization from parties and in amounts that were actionable. I shall address this *infra*.

2. Security Granted by Kingswood Entities

[560] As the Loans are valid and, accordingly, the principle debt remains enforceable, so too does the security granted by Kingswood. As such, I need not address the arguments advanced by Billes that, *inter alia,* Mason and McAteer are estopped from arguing that the Trust debenture is invalid on the basis of the Manitoba foreclosure proceedings.

3. BJ and TM

[561] In the Outline for Argument, the issue is stated thus:

> c. BJ and TM
>
> i. If there are consequences to BJ or TM, is any failure by BJ or TM excused, or are they liable to Billes and thereby responsible to contribute (in whole or part) to any damages payable to any other party? If so, why (in fact or law)?

The issue was similarly expressed later in the Outline for Argument in relation to the specifics of Billes' Third Party Claims against BJ and TM in the McAteer/Kingswood and Mason Actions. The issue is substantively the same in both except that the relief sought in the Mason Action relates to not merely setting the Loans aside but a remedy under the oppression provision of the *ABCA.*

[562] I will record my ultimate conclusions here and come back to the factual findings that form the basis for those conclusions.

[563] BJ and TM are named as Third Parties by *Billes et al.*. in the McAteer/Kingswood, Mason and Derivative Actions, in relation to the Trust and Newmat Loans respectively. Leaving aside the Derivative Action for the moment, the Third Party claim by *Billes et al.*. against BJ and TM in each of the McAteer/Kingswood and Mason Actions is specifically directed at the claims that the Loans were "invalid or unlawful or prohibited" by non-compliance with the USA and section 115 of the *ABCA*. In that context, *Billes et al.*. claim indemnity or contribution, if the Plaintiffs succeed in their claims, on the basis that BJ and TM were respectively "negligent and in breach of their duties" to Billes et al.. This claim for negligence is based on the allegations that BJ and TM knew or ought to have known of the USA, the provisions of section 115 of the *ABCA*, and the identity, roles, and relationships between the parties. Alternatively, Billes alleges that BJ and TM failed to make due and proper inquiry in those regards, and failed to properly advise *Billes et al.*

[564] As I have found the Loans valid, which was the basis for these third party claims, it follows that *Billes et al.* require no indemnification and the third party claims of *Billes et al.* are dismissed. However, even if I had found the Loans invalid for other reasons, I find that BJ and TM had no knowledge of the breaches alleged and are entitled to rely upon the indoor management rule. I find further that they were neither negligent nor in breach of any duty to Billes et al., to the same result.

[565] I have found Billes liable to Mason under the oppression remedy. However, I note that the Third Party claims by *Billes* are specifically in reference to the validity of the Loans and not in relation to the oppression remedy. They do however reference the same facts and rely upon the same failures. Moreover, paragraph 14(j) of the Third Party Notice contains a basket clause of "such further and other particulars of negligence", etc. In any event, assuming the pleadings are adequate, the conclusion to which I have arrived (lack of knowledge and lack of negligence), would absolve BJ and TM of any liability to indemnify or contribute to liability.

[566] I will address the Third Party claim of Billes against BJ and TM in the Derivative Action, *infra*.

[567] It follows that BJ and TM are not liable to indemnify Billes et al. in the McAteer/Kingswood or Mason Actions.

[568] As the liability of BJ and TM in relation to the Loans and the oppression remedy is dismissed on the basis of lack of knowledge of breach and lack of negligence, I need not comment on other related issues, including: the need for (or advisability of) expert evidence as to the standard of care of the "reasonably competent member of the profession"; and whether the Trust and Newmat, having regard to the timing of the advances of the Loans, relied on the work done by BJ and TM.

4. McAteer

[569] It follows from my findings that McAteer is unsuccessful in the McAteer/Kingwood Action in his request to have the Loans set aside on the basis of Billes' lack of disclosure. However, based on his role in relation thereto, I find him and Billes jointly and severally liable to Mason, under the oppression remedy in the Mason Action. Moreover, I find him liable to indemnify Billes for misrepresentation under the Billes Counterclaim in the McAteer/Kingswood Action and the Billes Third Party in the Mason Action, based on the same facts. I will discuss these conclusions, *infra*.

K. Conclusion

[570] I find Billes and McAteer jointly and severally liable to Mason for breaches of the USA and the *ABCA*, and, in my view, it is appropriate to rectify all such liability under the oppression remedy, where I grant judgment of $440,000.

X. THE McATEER/KINGSWOOD ACTION

A. The Claim

[571] The Statement of Claim in the McAteer/Kingswood Action is long on facts but short on allegations. The allegations against *Billes et al.* include: (1) that Billes would be a financial partner to McAteer to ensure that the DDL and Kingswood projects would obtain proper and adequate financing until completed and refinanced; (2) the Defendants, by breach of contract and

negligence, had conspired to take the DDL/Kingswood projects for themselves; (3) Billes induced McAteer not to proceed with financing arranged with Household Trust, but rather to borrow from Newmat, for the purpose of achieving (2); (4) the Loans were approved without Billes disclosing her interests contrary to the USA and the *ABCA*, and requesting the Loans accordingly be set aside; and (5) the Defendants had trespassed on and converted the Plaintiffs' property to their own use. The Plaintiffs also sought relief pending trial, including an independent receiver manager, and general and punitive damages.

[572] I have concluded that there is no merit to the McAteer/Kingswood action. I have largely dealt with the substance of each of issues (1) to (4) *supra.* I find that the allegations in (5) were a part of appropriate steps to realize on the security when the Loans were in default. Further, with respect to (5), I find that there were no actions by the Defendants after the execution of the Loans and their default which grounds liability against the Defendants. Additionally, there is no convincing evidence that there would have been any assets left for DDL after the realization. Accordingly, the entire claim in the McAteer/Kingswood Action is dismissed.

[573] However, I do find McAteer liable under the Newmat Counterclaim in the McAteer/Kingswood Action.

B. The Billes/Newmat Counterclaim

[574] The issue of McAteer's liability under the Counterclaim in the McAteer/Kingswood Action was set out in the Outline for Argument as follows:

> H. Liability and Damages on the Counterclaim in the McAteer Action No. 9201-19685?
>
> 1. On what factual and legal basis is Mr. McAteer liable to any of
> (a) Ms. Billes
> (b) Newmat
> (c) Estate Trust
> (d) Mr. Billes
> (e) others
> on the counterclaim in his alleged role as (i) a lawyer, (ii) a guarantor, or (iii) otherwise? Why or why not?
>
> 2. What are the factual and legal defences to the counterclaim?
>
> 3. If Mr. McAteer is liable on the counterclaim in his alleged role as (a) a lawyer, (ii) a guarantor, or (iii) otherwise, what are the damages? How are they calculated? Are there any setoffs?

1. The Billes Counterclaim

[575] There is considerable similarity between the allegations in the Billes Counterclaim in this McAteer/Kingswood Action and the Billes Third Party claim against McAteer in the Mason Action. The cause of action to which Billes is entitled to recover against McAteer is fraudulent misrepresentation. Billes is entitled to only one such recovery. Having regard to some limitations in the pleadings and prayer for relief in the Billes Counterclaim, I have determined that the relief is more appropriately granted under the Billes Third Party claim against McAteer in the Mason Action and accordingly I shall discuss that cause of action *infra* under the Mason Action.

2. Newmat Counterclaim - McAteer Guarantee

[576] In the Counterclaim by Newmat, it is alleged that:

> 33. On or about October 10, 1991 for valuable consideration and by written instrument under seal McAteer guaranteed payment to ... Newmat of the liabilities of Devoncroft under the Newmat Loan Agreement.
>
> 34. There were terms, *inter alia*, of the aforesaid instrument such that:
>
> (a) McAteer promised to make payment to Newmat in the amount of the liability of Devoncroft to Newmat up to the amount of $1,950,000.00 plus interest at the rate set forth in the Newmat Loan Agreement;
>
> (b) McAteer agreed to pay interest on the sum demanded at a rate equal to the rate or rates charged by Newmat to Devoncroft.
>
> 35. After accounting for all amounts advanced under the loan, credits received and interest accrued, there remains due and owing by McAteer pursuant to the said written guarantee as at February 1, 1995 the sum of $2,113,683.86 consisting of outstanding principal of $1,950,000 together with interest in the amount of $163,683.86. Interest continues to accrue thereon at the floating annual rate of interest established and announced as such from time to time by Alberta Treasury Branches on commercial loans plus 2 1/2% per annum.
>
> 36. By letter dated November 23, 1992, Newmat by its solicitors made demand upon McAteer pursuant to the guarantee to pay the sum of $2,054,424.36 but McAteer has failed and refused and continues to fail and refuse to pay that amount or any amount.

[577] McAteer acknowledged that he signed the McAteer Guarantee (Exhibit 63) and made no payments under it.

[578] As noted by Iacobucci J. at 413 of *Communities Economic Development Fund* v. *Canadian Pickles, supra* (cited by Mason for a different purpose):

> Generally speaking, if the principal debt is void or unenforceable, the contract of guarantee will likewise be void or un-enforceable: see generally, J. O'Donovan and J.C. Phillips, *The Modern Contract of Guarantee* (1985), at pp. 183-93.

[579] Although I agree that is the rule generally, I would note that Billes submitted a number of authorities which emphasized that the application of the rule is dependant upon the language in the written agreement and the factual matrix of the individual case: *Manulife Bank of Canada* v. *Conlin*, [1996] 3 S.C.R. 415; *Olympia & York Dev. Ltd. (Bkpt.), Re* (1998), 113 O.A.C. 52 (C.A.), refused leave to appeal (1999), 123 O.A.C. 399 (S.C.C.); *Garrard* v. *James*, [1925] 1 Ch. 616; *Heald* v. *O'Connor*, [1971] 2 All E.R. 1105 (Q.B.D.); *Bank of British Columbia* v. *Turbo Resources* (1983), 46 A.R. 22 (C.A.). She also argued that, as a guarantor who received a portion of the loan funds, the Breckenridge principle applied to McAteer, Club and Developments.

[580] However, here, contrary to the urging of McAteer, I have found the principal debt enforceable, and accordingly, no other real defence thereto being advanced by McAteer, the McAteer Guarantee is also enforceable.

[581] Further, I note that: McAteer covenanted with Newmat that DDL would perform its obligations (Loan Agreement, Article 7.01 - Exhibit 67); the McAteer Guarantee provided that it would be binding notwithstanding any defect in the Debenture or any failure of the security intended to be created by the Debenture; the guarantor undertook a "several", "absolute", and "unconditional" liability as if he were a principal debtor (Exhibit 63, Article 1.2); and the McAteer Guarantee contained an extensive waiver of common law defences (Exhibits 63, Article 3.1).

[582] In accordance with the pleading, and based on the evidence, I find McAteer is liable on the basis of his Guarantee to Newmat (Exhibit 63), in the sum of $1,950,000, less any further credits due, plus interest accrued from November 23, 1992.

[583] I note that the Draft Judgment Roll filed herein by *Billes et al.* reads as follows:

> Newmat is hereby awarded judgment against McAteer in the amount of $3,233,041.89, together with interest thereon pursuant to the guarantee from and after March 15, 2000 at the rate of Alberta Treasury Branches prime rate plus 2 ½%, to be calculated and compounded annually (in accordance with the Loan Agreement - Exhibit 67)[32] utilizing Alberta Treasury Branches month end closing prime rate.

[584] Billes and Newmat argued that “The amount outstanding on the Newmat loan as at March 31, 2000, is $3,026,966 (Exhibit 422), or alternatively $2,715,379 (Exhibit 423). As I

[32] In fact, I note that Exhibit 67 provides for interest to be compounded monthly, but that would only apply to the date of this Judgment.

understand it, the former is based on compounding monthly and the latter is simple interest. I find that the former is in accordance with the Loan Agreement (Exhibit 67) and the McAteer Guarantee (Exhibit 63, which refers back to the Loan Agreement). However, I have not recalculated it, and accordingly leave it to Counsel to calculate and agree on the amount owing to the date of these Reasons, and insert same in the Judgment Roll, or, if Counsel cannot agree, to re-attend before me to determine same.

XI. ENFORCEMENT AND REALIZATION OF SECURITY

[585] For the reasons discussed *supra,* I find that the terms of the Loans were reasonable and fair as between DDL and the Lenders, and that the Loans were valid upon execution. The next series of questions relate to whether something occurred after their execution to prevent or limit the ability of the Lenders to enforce their security, approved their right to enforce their security, and whether, on realizing on their security, they took any steps that were actionable.

[586] As noted *supra*, this matter was initially raised in the consequential fact conclusions part of the Outline for Argument in these terms:

> What was the realized value (post receivership/bankruptcy) on the disposition of assets of DDL and the Kingswood entities which are in issue? What are those issues? How do they relate to the decisions that will have to be made in connection with the larger issues which arise in these proceedings? How do they relate to appraised values?

[587] What follows is a discussion on these issues.

A. Enforceability - Interest Deferral

[588] The issue of enforceability, having regard to alleged interest deferral, was stated in these terms in the Outline for Argument:

> Did the lenders under the Trust Loan and/or the Newmat Loan, in fact, defer interest? What evidence is there to support/refute this? If so deferred, for what period? Does this affect the default and calling of the loan(s) such that the demand and subsequent receivership is invalid? If the answer is affirmative, is the Manitoba court action *res judicata* to any such conclusion?

[589] After a review of the arguments, it appears that the deferral of interest has really become a non-issue and I find that it did not adversely affect the Lenders in enforcing their security. However, I will set out my reasons for that conclusion. I will address the issue of *res judicata* below.

[590] Billes cited the following alleged (partial) facts in response to the issue:

> - March, 1992. McAteer seeks concessions from Mrs. McLarty, Owen Billes and the Trust on the terms of their loans, citing difficulty in paying

(Exhibits 85A, 86). Billes suggests McAteer consider making a proposal for the Trust trustees to consider deferring interest for two to three months (Exhibit 87). ... Billes advises the Trust will assist DDL by allowing it to accrue until July the payments due April 1, May 1, and June 1 (Exhibit 89).

- April - May, 1992. DDL is in default on Trust and Newmat loans.

- May, 1992 and thereafter. The Kingswood entities cannot pay all their debts accruing due May 26, 1992. McAteer describes cash needs and requests Billes provide a $171,000 credit facility (Exhibit 321).

- June 5, 1992. Albikin advances $60,000 to DDL to assist paying unsecured creditors. (Exhibit 99).

...

- November, 1992 [Lenders Loans called]

[591] Exhibit 89, a letter from Billes to McAteer dated March 27, 1992, offers deferral and accrual of interest from the Trust Loan for April to June. Exhibit 99, being a memorandum from Billes, signed by both Billes and McAteer, appears to refer to a previous agreement:

> These monies are not to cover any interest payments to Trust or to Newmat, both of which have agreed to let the interest due accrue for several months until the cash flow in Kingswood/DDL has improved....

[592] I find as a fact that there was an oral agreement between Billes and McAteer (confirmed in writing without clear specificity in Exhibit 99) that the Lenders would not enforce their security over an unspecified period time during the summer months of 1992. I note, as to timing, that Billes in her undated July 1992 letter (Exhibit 107) to McAteer referred to an October 15th deadline. However, Lavery's evidence was that "there was no definitive understanding as to when it would end". Billes acknowledged that she had agreed on behalf of the Lenders that "those two entities would let the interest accrue for several months, i.e., until the revenues improved, cash flow would improve before the fall", and that both Lavery and Newell had concurred. There was an attempt by McAteer (through Marshall) to put this into an agreement in August 1992 (effective to September 1993), but it was never accepted by the Lenders (Exhibit 121, and testimony of McAteer).

[593] Is such an agreement binding on the Lenders? I find that the agreement was not legally binding on the Lenders, but was nevertheless acquiesced in by the Lenders. There are several reasons why I find it was not legally binding, including: there was no consideration; there was a lack of clear and unequivocal intention on the part of the Lenders to formally waive payment, as opposed to Billes personally (although it appears the Lenders went along with her wishes - see *Sask. River Bungalows* v. *Maritime Life,* [1994] 2 S.C.R. 490 at 501); and, *vis-à-vis* DDL, it was

orally agreed to only by Billes, without written agreement by the Lenders, in contravention of a written agreement to the contrary (e.g., Newmat Loan Agreement, Article 1.04 - Exhibit). However, the fact that Billes appeared to agree to it on behalf of both Lenders is some indication of her influence over the Lenders. Moreover, the Lenders did not try to enforce their security during this time; not until November. I find that to be at the end of the duration of this non-binding oral agreement. Accordingly, no issue arises.

[594] In any event, neither Mason or McAteer seemed intent on pursuing the issue. Mason argued: “Mason does not take the position that the subsequent demand and receivership of Devoncroft is invalid strictly on this basis”. While McAteer referred to “the Law and Argument under the Trust Section above”, no submissions on this point can be found in the argument.

[595] Billes argued further that “This point is not pled. We submit it ought not to be considered by the Court”.

[596] In view of the lack of enthusiasm for this issue (non-issue?), I shall not pursue it further, other than to conclude that the oral agreement to defer interest payments by DDL under the Loans had no impact on the Lenders enforcing their security after November 1992.

B. Enforceability - Failure to Obtain Market Value

[597] There was an undercurrent throughout the trial by Mason and McAteer that the Lenders disposed of the security for the Loans at considerably under value, often to closely-held, non-arms-length number companies. The corollary argument was that the value of the security exceeded the amounts owing under the Loans. This was in specific reference to the allegation in paragraph 29(i) of the Amended Statement of Claim in the Mason Action that:

> ...in the enforcement of the Estate Debenture and the Newmat Debenture, the Defendants Billes, Lavery, Mann and Owen G. Billes improperly instructed and caused the receiver to realize upon the assets of DDL in order to appropriate such assets for themselves or any one or more of them, to sell such assets to non-arms-length recipients or to sell them to third parties, all at prices significantly below fair market value and in a commercially unreasonable manner;

Accordingly, parties were requested in the Outline for Argument, in the section on “Evidence”, and, in particular, “Consequential factual conclusions”, to reply.

[598] Later in the context of Enforceability of the Loans, a similar question was asked in the Outline for Argument in these terms:

> Did the Estate Trust and Newmat fail to act in good faith, or fail to take reasonable precautions to obtain market value for DDL’s assets on sale? If so, what consequences follow?

I will deal with these two overlapping, substantially similar, issues together.

[599] Mason described the issue in these terms:

> Have the Trust, Newmat or Sill Streuber (the Receiver)[33] satisfied the Court that they acted in good faith and took all the necessary steps to obtain the best price that was reasonably obtainable at the time in respect of the sale of the Devoncroft/Kingswood assets?

[600] I have set out under the heading “General Facts” (*supra*) the basic elements of the realization on the security by the Lenders. At issue specifically, is the sale of DDL’s interest in HAL, the sale of the Golf Dome, and the sale of the Kingswood Golf Course.

[601] Focussing on the second related issue in the Outline for Argument, regarding value on disposition of assets in general, and in the context of the specific opinions of Billes’ experts, Billes argued:

> It is submitted that the onus of proof is on the Plaintiffs to show that a loss was suffered. The cause of action for alleged disposition of the hard assets, lies only with the Kingswood entities [whose assets were pledged as security for the DDL Loans, as Kingswood received the lion’s share of the proceeds]. The Kingswood entities did not plead this, and it warrants no further consideration.
>
> Alternatively, the record amply demonstrates that fair value was obtained for the assets, and even if not, the debtor suffered no loss because there was no equity in any of the assets.
>
> The Golf Dome was disposed for $648,000 cash. Appraisals supporting that value were obtained. Mr. Cooke gave evidence with respect to his appraisal and ..., it ought to be accepted. There was no equity in the security.
>
> It is submitted that in light of the HAL financial statements in Exhibit 186, the McGregor appraisal [as at November 27, 1992 - Exhibit 384], and the report of Mr. Cristall, there was no value in the HAL shares. There was no equity in the security.
>
> The front nine of the golf course was foreclosed by Court Order, thus extinguishing the Trust debt. The Court of Queen's Bench in Manitoba determined to grant a final order of foreclosure after the property had been unsuccessfully offered for sale. It is respectfully submitted that no further inquiry need be made.

[33] Sill is not currently a party to these proceedings, and therefore there can be no liability against it.

> Even if fair value was not obtained, no consequences follow. Only the Kingswood entities would have a remedy for the disposition of their assets below fair value. They did not plead nor request any remedy arising from alleged disposition at amounts less than fair value. Nor was there any equity in the security.
>
> Even if there were a remedy, the proper remedy would be damages: excess of value over amount owing. The suggestion by Mason's counsel (without citing any authority) that a constructive trust ought to be imposed, is without foundation, particularly when the creditors do not owe any fiduciary relationship to DDL, lone the Kingswood Entities, and would result in a windfall as there was no excess of value in any of the assets over the amount owed.
>
> Further, the creditors' ability and expectation that they would act in their own interests, displaces any notion of a fiduciary obligation: *Ironside* v. *Smith* [(1998), 70 Alta. L.R. (3d) 393 (C.A.)], at 412-414.
>
> As to the issue of good faith, the Court ought to consider the primary motivation (*Teck Corp. Ltd.* v. *Millar* (1972), 33 D.L.R. (3d) 288 at 325-327 (B.C.S.C.)). It is submitted that the evidence demonstrates that the Trust and Newmat acted in good faith in their decision to call the loan and realize on the security. We refer to the evidence ... that the companies were in a hopeless financial condition and the lenders were acting to protect their rights. Ultimately, McAteer voluntarily assigned the Kingswood entities into bankruptcy. The lenders indicated that a proposal whereby McAteer remained in management would not be entertained, but did not say that no proposal would be entertained. No proposal was forthcoming. The lenders' concerns over the competence of McAteer as a manager, have been amply demonstrated in the record.

I agree with the substance of Billes’ submissions generally, with some observations, that I will make in examining specific dispositions.

1. Disposition of HAL

[602] Sill, the DDL receiver, sold the one half interest of DDL in HAL to Billog for $7,500.00 (Exhibit 267) on October 25, 1994. Newmat agreed (Exhibit 424) to fund the purchase cost and certain operating expenses. In August 1995, the assets were sold for a condominium project (Exhibits 343 and 350) for a gross selling price of $1,050,000 (Exhibit 343 - close to the appraised value as at January 1991 of $1,020,000 - Exhibit 345) for an after expense (including reimbursement of Newmat) profit of $99,667, $39,867 of which would have been Billog’s 40% share (Exhibit 424).

[603] Mason argued that Sill made no effort to market DDL's interest in HAL or to determine the fair market value[34] of that interest prior to sale.

[604] In response, Billes replied:

> Both Mason and McAteer were given notice of this proposed disposition and were given prior opportunity to purchase same for $7,500 (Exhibits 226 and 226A). No suggestion was made by them that some other disposition or some other price would be appropriate. Best gave evidence that it would be very difficult to market a one-half interest in a privately held company as this. Cristall's report (Exhibit 393, Schedule 3) suggests that the interest in Home At Last was worthless, and no contrary evidence has been adduced by the Plaintiffs. Further, there was no equity in the security; thus, this issue is not material to the issues in this suit.

I accept the conclusion that follows from the latter argument, namely that neither Mason nor McAteer have any actionable complaint, on the evidence, in relation to the value realized by the sale of the HAL shares. Even more important, McAteer knew what the value was in January 1991 (Exhibit 345), and what was owing, and had the ability to determine whether or not to purchase the asset. He chose not to do so.

2. Disposition of the Golf Dome

[605] On March 25, 1994, 3038319 Manitoba Ltd., a wholly owned subsidiary of Albikin, purchased the Golf Dome from Newmat nominee, 2809291 Manitoba Ltd. (“280"), for $648,000.00 (Exhibit 246).

[606] Mason argued:

> The appraisals received at the time Newmat's nominee disposed of the Golf Dome as a "mortgagee" in possession, do not reflect the fair market value of the Dome. The appraisals on hand were E.P. Cooke Real Estate Services Ltd. - $638,000.00 (Exhibit 238) and Realty World between $620,000.00 and $650,000.00 (Exhibit 241).

Mason was critical of Cooke’s appraisals. I will address those issues in a separate section.

[607] In the reply argument, Mason further argued:

[34] For this purpose the definition of fair market value that I accept is that discussed, *supra*.

... it is submitted that a heavy onus lies on Newmat (through its wholly owned subsidiary 280) to show that in all respects it used its best endeavours to obtain the best price reasonably obtainable on the sale of the Golf Dome. In *Tse Kwong Lam* v. *Wong Chit Sen and others*, [1983] 3 All E.R. 54 (P.C.), Lord Templeman states at 59:

> In the present case in which the mortgagee held a large beneficial interest in the shares of the purchasing company, was a director of the company and was entirely responsible for financing the company, the other shareholders being his wife and children, the sale must be closely examined and a heavy onus lies on the mortgagee to show that in all respects he acted fairly to the borrower and used his best endeavours to obtain the best price reasonably obtainable for the mortgaged property.

The ownership structure of 303 (the purchaser of the Golf Dome) and 280 (the mortgagee in possession, who held the Golf Dome as a bare trustee for Newmat) at the time of the transaction is set forth in Exhibit 247. Billes through Albikin held a 100% beneficial interest in 303. Billes, through Marlore and Newmat, held a significant beneficial interest in 280 and was a director of 280.

[608] Billes replied:

The Golf Dome was sold for $648,000 in accordance with Section 135 of the *Real Property Act* (Manitoba) [R.S.M. 1970, c. R30]. ...The Assistant District Registrar ordered that the land may be offered for sale by 280 (Exhibit 221). Prior to disposing of the interest, an appraisal was filed with the Manitoba Land Titles Office (Exhibit 238), as was a valuation estimate (Exhibit 241). Both reports are supportive of the value actually used. Counsel held an opinion from a firm of Chartered Accountants that the sale was arm's length (Exhibit 247). The District Registrar in the Land Titles Office authorized the sale (Exhibits 254, 256). Both Mason, and McAteer, were given notice of the proposed disposition, and made no suggestions that the value was inappropriate (Exhibit 269). Neither led any evidence to demonstrate that the disposition did not comply with Manitoba law, nor was such an allegation pled.

The Plaintiffs have adduced no evidence in the form of valuation opinions or estimates suggesting that the Golf Dome was disposed of for an amount less than its fair market value, or that the disposition was commercially imprudent. We submit the reverse onus does not apply because the purchaser from 280 did not have an ownership interest in 280. Further, as there was no equity in the property, the issue of disposition is not material to the issues in this suit.

[609] I would observe that, as I understand it, s.135 of the Manitoba *Real Property Act* is merely regulatory in nature in that it sets out the procedure to be followed on an application for an order to sell property in default of payment. Billes may be correct in arguing that the appraisal submitted to the Manitoba Land Titles Office may be “supportive” of the value of the Golf Dome. However, that appraisal does not bind this Court or the other parties to this action with respect to the value of that property. Additionally, I note that the opinion of Coopers & Lybrand (Exhibit 247) was merely “for the purposes of the *Income Tax Act*” R.S.C. 1985 (5th Supp.), c.1, and does not determine whether the sale was at arms length for the purpose of being a valid fair market value indicator. Indeed the letter stated:

> ... it is a question of fact whether or not unrelated persons are dealing at arm’s length. A transaction between unrelated parties does not necessarily indicate an arm’s length transaction. The prime factor of importance is separate economic interests which reflect ordinary commercial transactions between parties acting in their own separate interests.

In my view the onus remains on Billes and Newmat to show that the best price obtainable was secured. I find further that they have satisfied that onus. Specifically, they have led evidence, namely the appraisals, which indicates that the price obtained was within the suggested range. While Mason has taken issue with this, neither she nor McAteer have put forward any evidence to the contrary.

[610] McAteer argued a different point:

> The Golf Dome was sold to a corporation wholly owned by Billog (Exhibit 271) for $648,000.00. The purchaser entered into a management agreement with Newmat (Exhibit 426). Newmat has earned management fees totalling $723,898.00 to date (Exhibit 427). This transaction has provide both Newmat and a related party to Billes, her son, to profit greatly from seizing control of this asset.

[611] Billes responded:

> McAteer suggests that Newmat has earned a management fee totalling $723,898 to date (Exhibit 427). Exhibit 427 records management revenue from 303, not from the borrowers, pursuant to the agreement with 303. From that revenue, Newmat paid salaries for the Golf Dome manager and expenses; Mr. Newel also put his time into these services.
>
> No interest has been paid on the Newmat loan since the spring, 1992, and it is apparent from Exhibits 422 and 423 (loan balance calculations) that even if one equated management fees from 303 to profits from the borrowers (which we submit is not sound), the net benefit to Newmat is negative. It is unclear what reasoning underlies McAteer's submission that the transaction has provided both

> Newmat and Owen Billes to profit greatly from seizing control of the asset. ... that proposition is legally infirm and factually infirm.

I see nothing that is actionable in an entity with close ties to a creditor providing services for the operation of a seized asset.

[612] Accordingly, I find that the disposition of the Golf Dome was for fair (albeit forced sale) market value, and that Newmat and those "down stream" from Newmat, have satisfied the onus upon them in this regard.

3. Disposition of the Golf Course

[613] Regarding the golf course, the front nine holes were foreclosed to the Trust by the Court of Queen's Bench of Manitoba. The back nine holes were realized on security by a third party and sold to a fourth party. The 18 holes were later bundled together by 3138993 Manitoba Ltd., a wholly owned subsidiary of the Trust, and sold to a Curtis owned Manitoba corporation (311) for $1,225,000.00 (Exhibit 366).

[614] As Billes summarized, Peter Miller, a Chartered Accountant and chartered business valuator, issued reports as follows: Exhibit 270; Exhibit 390, re: Kingwood 18 holes as at November 27, 1992; and Exhibit 392 re: Kingswood 9 holes as at April 23, 1990 and March 21, 1991 (back 9 not yet completed). The summary continued:

> The first report was an estimate of fair market value of the Kingswood 18 holes for $1,180,000 to $1,385,000 as at August 31, 1993 or the Kingswood front nine for $500,000 to $700,000 with a midpoint of $600,000 as at August 31, 1993. His later reports did not arrive at a conclusion of fair market value. He was asked whether the value could have been higher and in his view he was comfortable concluding that fair market value would not be higher than in 1993. In his view the value was at its highest in 1993.

[615] As Mason noted: his opinion was based on discussions with Gary Curtis, who did not testify before the Court; Miller only made comments (as opposed to providing an opinion) as at April 23, 1990 and March 21, 1991; and Club LP was in bankruptcy at the time of Miller's August 31, 1993 opinion. Mason also argued that, in addition to the above, the weight given to his opinion should be impacted by the fact that he had not:

> (a) given any consideration to the transaction by which Billes purchased an interest in DDL or the Murray Buyout or the Curtis buy-in;
> (b) reviewed the state of the golfing industry in Manitoba at the applicable dates; and
> (c) referred to the financial statements with respect to Club LP.

I note these arguments but, as no evidence was provided to contradict Miller's testimony, I have no sound basis upon which to reject it.

[616] Mason argued:

> The Trust ... sold same to 311 for $1,225,000.00 (Exhibit 366). The Trust purchased the back 9 holes of golf for the sum of $500,000.00. This means the front 9 holes of golf had a value of $725,000.00 in this transaction. The Trust entered into an agreement with Gary and Wayne Curtis (Exhibit 367) whereby on the subsequent sale of the 18 holes of golf by either Curtis or 311 they agreed to pay the Trust 50% of the sale proceeds [net over the purchase price in Exhibit 366] to a maximum of $650,000.00. If the amount to be received by the Trust was less than $650,000.00, then the Trust could veto any sale of the golf course.

[617] To this Billes replied at length:

> The front nine holes of the golf course were disposed by order of foreclosure of the Court of Queen's Bench of Manitoba. It is submitted that any further transaction is not material nor subject to any reverse onus, since the sale was not to a related party, a foreclosure order was granted and Club was unwilling or unable to exercise any remaining right to redeem. It is submitted that the back nine holes are not in issue - they were disposed of by another lender.
>
> Mason's counsel suggests that because the Trust bundled the 18 holes together and sold the same [for] $1,225,000, then the front nine holes had a value of $725,000 in that transaction.
>
> This suggestion is inaccurate. Billes gave evidence (Billes, 1895-1896) that there was a very complex series of transactions that took several months to reassemble the back nine and the front nine. In particular the documented transaction at Exhibit 366 provides, *inter alia*:
>
> (a) In the Agreement of Purchase and Sale between 311 (Curtis' Corporation - Purchaser) and 313 (Trust's Nominee - Vendor)
>
> - The Agreement was not a cash transaction
>
>   paragraph 5(b) - Purchaser to assume $150,000 of obligation to Wall/Docking Corporation (3088406 Manitoba Ltd.("308"))
>
>   paragraph 5(c) - $50,000 payable a year from date of agreement
>
>   ...

- required Vendor's continued assumption of potential unlimited liabilities arising out past course issues (Exhibit 367, paragraph 8)

(b) In the Agreement of Purchase and Sale between 313 (Trust's nominee - Purchaser) and 308 (Wall/Docking Corporation - Vendor) concerning Back Nine (Schedule A to Ex. 366)

- subdivision required between unsubdivided lots and Back Nine (Pages 6, 7 and 8 of Schedule A)

- this Agreement was also not a cash transaction.

  paragraph3(c) - $220,000 by assumption of mortgage
  paragraph 3(d) - $150,000 by Debenture to be paid over a year later

- Interim Operations Agreement required (paragraph 5)

Therefore it is incorrect to argue these series of transactions suggest a $725,000 value for the front nine. Without attributing value to each of above, these series of transactions are not useful as a comparable for the front nine. Further the whole of the Golf Course ($1.2 million with above restrictions) is worth considerably more than half a golf course.

[618] I believe that Billes’ first point covers the issue. The security, in the front 9 not being redeemed, was foreclosed out to the security holder (the Trust) for whatever future it may have had. What happens thereafter is of no relevance. The back 9 was not security realized on by the Trust.

[619] The significance of the Mason argument on the numbers is not clear. The midpoint of the Miller appraisal of the front 9 (which Mason criticizes) was $600,000. If Mason is correct in her analysis, the Trust nominee got $725,000, more than the appraisal value. However, even if that were the case, that, as I understand it, was still less than the amount owing on the Trust Loan. What is actionable from this analysis? Moreover, there is no evidence by Mason to contradict Billes’ assertions of value. The ultimate sale price would appear to relate to more than the difference between the sale of the total package and the purchase cost of the back 9. That is, the value of the whole 18 holes was, understandably, more than the sum of the parts.

4. Cooke Appraisals

[620] Edward Cooke provided the following appraisal evidence:

- Exhibit 385 Re: Phase 1 Residential Lots -- value of $1,477,000 at April 23, 1990;

- Exhibit 385 Re: Phase 1 Residential Lots -- value of $889,000 at March 21, 1991;
- Exhibit 386 Re: Proposed Phase II Unsubdivided Lots -- value of $217,000 at March 21, 1991;
- Exhibit 386 Re: Proposed Phase II Unsubdivided Lots -- value of $195,000 at October 10, 1991;
- Exhibit 386 Re: Proposed Phase II Unsubdivided Lots -- value of $162,000 at November 27, 1992;
- Exhibit 388 Re: 26 Phase I Lots -- value of $710,000 at November 27, 1992; and
- Exhibit 389 Re: Golf Dome -- value of $631,000 at November 27, 1992.

[621] Mason and McAteer were critical of Cooke's appraisal of the Kingswood golf course, lots, development land and Golf Dome. Generally speaking, their criticism went to the following issues: deduction of expenses for selling lots and development of lands, including a developer's profit fee of 15%; his opinions were retrospective and involved the use of hindsight; his opinion was based on a liquidation scenario not sales of lots, or the operation of the Golf Dome as a going concern; his locational and functional obsolescence gave him an opinion less than the costs of building, without providing any market comparable; and using the income approach he deducted management fees and prepaid income. They concluded:

> It is obvious that Mr. Cooke did not like the Golf Dome, as it was a new different structure, the Development lands, as the lots were situate near La Salle, and he did not consider the synergistic effect of golf course and residential lots. We submit that his appraisals be given minimum weight and that his opinions be given no weight at all.

[622] Neither Mason nor McAteer provided any rebuttal appraisal reports to deal with any of these issues. There may be some conclusions on these issues at which the Court could arrive as a matter of common sense, but the Court does not have expertise as an appraiser, does not know the market, and is therefore largely left with the option of accepting the only evidence it has or rejecting the opinions provided. As these are questions of fact, I have no expert evidentiary basis on which to do the latter and am left with the former. However, dealing with the specifics, I would refer to the evidence of Siebert and make some further comments.

[623] Siebert provided some valuable analysis of the valuation alternatives and the reasons for them:

> A liquidation approach would be used if a business was not viable as a going concern. A going concern approach would be used for a continuing business enterprise with potential for economic future earnings or cash flows.

I agree that the evaluation should have been done on a going concern basis, not a liquidation basis, but, Billes argued that Cooke did not use a liquidation approach:

> In each instance, his definition includes that there is to be a reasonable time for the disposition of the property - not a liquidation type of sale. His evidence was that his approach was not a liquidation approach. The starting premise was the market value for the lots; he did not discount the lot values.

In any event, even if it were on a liquidation basis, I have no evidence upon which to determine what the different value would have been.

[624] I find that development costs and profits taken in the sale process are a proper deduction in arriving at value. If an external sales agent is used, this cost comes off the gross sale price to provide a net sale price. If internal agents are used, the recovery might be somewhat higher, but still salary and commission must be deducted. I am unable to assess whether 15% is appropriate or not, but there is no other evidence upon which I might rely.

[625] Appraisals are often, necessarily, retrospective, as Cooke testified. In most cases, for a current date appraisal one is using comparative sales from some reasonable time past and then making adjustments to estimate the current value. If you are doing an appraisal for some past period, you often have more reliable data before and after the effective date, which can often make the process of estimation more realistic. In other words, you know what the market was actually saying at the time in question. I see no problem in retrospective opinions and the use of hindsight, so long as the analysis is properly done, if the issue is to determine the value at that past time, as was the exercise here. However, one must provide an opinion of value only at the relevant date. Moreover, one must be careful in using data after the effective date, because it may contain positive or negative stimuli that were not known to the market at the effective date. In any case it is also important to make adjustments as necessary to reflect the market at the relevant date. This is what was meant, as argued by Billes:

> Cooke agreed with the basic proposition that the valuator only consider those circumstances that exist at the valuation date. Cooke did include some statements in his report which would not have been available to a prospective purchaser in 1991 (Exhibit 386, bottom of page 11). In the case of the Golf Dome, Cooke said the appearance of the Dome when he saw it made him question the expected life of the fabric, but he said that did not enter into his calculations. He said it did not influence the value because at the effective date of the appraisal the structure was new. He agreed that a purchaser in 1992 would not have the benefit of the knowledge of the condition of the structure at the time it was inspected by Cooke.

[626] As to locational and functional obsolescence of the Golf Dome, if it were not going to be used as a Golf Dome, then it may well be less valuable than if continued for that purpose. For unique structures, as this was, it is often difficult to find comparables that are relevant and helpful. In this regard, Cooke stated, as summarized by Billes, that: “... the structure was unique, and it did not have a lot of uses”. For that reason, or if the operation is to continue on, then one needs to appraise it on a cost basis or an income basis to determine what someone would pay for

the property to earn revenue. Expenses to generate such revenue are a proper consideration in order to determine what net income can be generated.

[627] As to Cooke's views of the Development and its components or synergies, the Court does not have the expertise to assess the views of the market as to values in relation to Cooke's opinion. If one is of the view that Cooke's opinion was not what the market would consider appropriate, the proper course is to provide a rebuttal opinion. As Mason and McAteer chose not to do so, the Court's hands are considerably tied as noted *supra*.

[628] In the circumstances of this case, I find no convincing reason why Cooke's appraisals should not be given full weight.

[629] BJ argued "The Court should not conclude from McAteer's testimony that DDL/Kingswood had inherent value in excess of its debt load." I agree with this at the time of enforcement of the security.

5. Conclusion

[630] Having considered all of the evidence, and the aforementioned arguments, I find that the Lenders have presented evidence and argument sufficient to support any onus upon them to demonstrate that fair market value was received through the disposition of all three of these assets. I find further that Mason and McAteer have failed to provide evidence, or convincing argument, to overcome that position.

[631] In the result, I can dispose of these issues as a matter of substance, and need not rely upon the argument of Billes on the adequacy of pleadings. I would note, however, that nothing to the effect of less than fair market value being received was pled.

[632] As a result, I find that the Lenders acted in good faith and obtained fair market value (perhaps in a forced sale situation, which adversely affects value) for the security that DDL pledged (through Kingswood) for the Loans.

C. *Res Judicata* and the Manitoba Litigation

[633] The issue of *res judicata* flowing out of the Manitoba litigation arose a number of times in the Outline for Argument. In the context of enforceability relative to deferral of interest, discussed *supra*, the issue was raised in these words as to whether *res judicata* overcame any limitations or restrictions in enforcing the security:

> Does this [deferral of interest] affect the default and calling of the loan(s) such that the demand and subsequent receivership is invalid? If the answer is affirmative, is the Manitoba court action *res judicata* to any such conclusion?

[634] Later in the same section of the Outline for Argument, as a form of “catch all”, it is raised again:

> Is there any other reason why the Trust Loan or Newmat Loan were unenforceable? Is any such unenforceability overcome by/not required to be considered by *res judicata* premised on the Manitoba Court orders? What consequences follow?

[635] It was also raised in the context of the Derivative Action, which I will discuss, *infra*.

[636] The issue came down to whether the Manitoba litigation estopped the current actions, limited some aspect of them, or had no effect on either. I find that it had the effect of determining some specific issues (e.g. the lack of a collateral agreement limiting the enforceability of the $1,000,000 construction loan; terminating the interest of Kingswood to the front 9 based on the foreclosure of that security; etc.), on which I have come to similar conclusions on the merits, independent of the earlier litigation. However, I do not find that the Manitoba litigation had the effect of estopping Mason and McAteer from bringing the Mason Action and McAteer/Kingswood Action. I will analyze the arguments that led me to this conclusion.

[637] Billes alleged that DDL, Mason and McAteer are estopped from bringing the present action on the basis of *res judicata*. Specifically, Billes submitted that Mason and McAteer were either parties or privies to the Manitoba litigation.

[638] Mason countered that she was not a party to the litigation, as she was not named as a party nor served with the Notice of Motion, and that Kingswood Club Ltd. and Club LP were the only Defendants named. She does acknowledge that she applied unsuccessfully for a stay of the foreclosure procedures pending the determination of the validity of the Trust Loan in Alberta. She argued further:

> The criteria for finding privy have been discussed at page 221 of the decision of *420093 B.C. Ltd.* v. *Bank of Montreal* (1995), 174 A.R. 214 (C.A.). In essence, privies include any person who succeeds to the rights or liabilities of the party, but it is essential that he who is later to be held estopped must have had some kind of interest in the previous litigation or subject matter. It is an essential of privity of interest that the privy must claim under or through the person of whom he is said to be a privy. Privity is not established merely by having "some interest in the outcome of litigation". There must be a sufficient degree of identification between the two parties to make it just to hold that the decision to which one was a party should be binding in proceedings to which the other is party.
>
> Simply stated, when one considers the actions being advanced by DDL and Mason in these proceedings (i.e. principally being a breach of fiduciary duty and oppressive conduct), these are separate and distinct causes of action and are not

"claims under or through the Kingswood entities". Accordingly, the assertion that *res judicata* applies to the actions of Mason and DDL ought to be dismissed.

[639] Mason's argued further:

> It is also significant to note that Sill was appointed as receiver and manager of DDL pursuant to the Trust security and the Newmat security on November 27, 1992 and that this appointment continued through the period of the foreclosure on the front nine holes of golf (January 24, 1994) and the sale of the Golf Dome by Newmat's nominee (March 25, 1994). Hence, DDL was under the control of the lenders at the relevant times and was not in a position to act independently to oppose the Manitoba proceedings.
>
> ...
>
> In a somewhat analogous situation, the Alberta Court of Appeal has dealt with the argument being put forward by Billes in respect of Mason in *Angus* v. *Angus (R.) Alberta Ltd.* (1988), 85 A.R. 266 (Alta. C.A.). Belzil, J. A. speaking for the court states at 273:
>
>> …The trial judge further held that the plaintiffs had an obligation to intervene in the action commenced *against the company* by the selling shareholders and to appear at and oppose the application for an order for specific performance, and that, having failed to do so, they were now estopped from seeking relief in the present action. No authority was quoted by the trial judge or advanced by the respondents, and none has been found, to impose such an obligation upon a shareholder. In my opinion no such obligation is recognized in law. Indeed, it is questionable that a shareholder would have status at all to intervene in his capacity as shareholder. Even if they had been cited as parties they would not be estopped if the issue were not really litigated: Spencer-Bower, *Res Judicata*, 2nd ed., p.44. [Emphasis added.]
>
> Contrary to the assertions put forward by Billes ...the validity of the Trust loan was never really litigated in the Manitoba action.

[640] Billes countered:

> ... The loan has been foreclosed in the Court of Queen's Bench of Manitoba. Kingswood Golf & Country Club was a party to that litigation. Mason actively participated in that litigation by opposing the Trust's application and applying for a stay. McAteer participated in that litigation by applying for a rehearing (which was unsuccessful), and then conducting an appeal (which was dismissed for lack of prosecution).

I agree with this statement of fact.

[641] Billes argued further that the definition of privy to litigation in Alberta is wide and flexible. In that regard she relied on *Argentia Beach (supra)* and *420093 B.C. Ltd.* v. *Bank of Montreal (supra)*. On that basis she submitted DDL, Mason and McAteer were privies to the Manitoba litigation, if not parties. Where the interests are so closely aligned as was the case in *420093 B.C. Ltd.* and *Argentia Beach, supra*, the court should make a finding that they are privies. The fact that both McAteer and Mason actively participated in various aspects of the Manitoba litigation, presents a compelling case for binding them to the result of the Manitoba litigation.

[642] Alternatively, Billes argued in light of their active participation in the Manitoba litigation, the Court should exercise its jurisdiction to prevent an abuse of its process. She cited *Roenisch (supra)* (Q.B.), as an example of where the court has exercised such jurisdiction.
[643] Finally Billes argued that the judgment of a sister province like Manitoba ought to be recognized in Alberta. She cited *Morguard* v. *De Savoye*, [1990] 3 S.C.R. 1077 and *Wavel Ventures Ltd.* v. *Constantini* (1996), 193 A.R. 81 (C.A.), [1999] S.C.C.A. No. 279, in that regard. Relying on *Malik (supra)* and *LRSCO Investments Ltd. (supra)* she stated further that, a final order of foreclosure is a final order for the purposes of the rules respecting *res judicata* or issue estoppel. Accordingly, she submitted:

> What is occurring in this case is precisely the type of litigation by installment which our Court of Appeal in *LRSCO Investments Ltd.* labelled an abuse of process. It was necessary for the Court of Queen's Bench of Manitoba to come to a conclusion that the security was valid and enforceable, before it could order foreclosure. Many of the issues raised in this suit, were raised by Mason in her initial opposition (as can be seen from the affidavit which she swore), or were raised by McAteer in his letter to the Court of Queen's Bench of Manitoba, and were issues in the appeal (the appeal books are reproduced in Exhibit 270).
>
> It is not open for the Plaintiffs in this suit to suggest that the construction mortgage is invalid or unauthorized, or that the lenders do not have title to it, or that a collateral agreement existed which prevented the loan from being called. The lender's rights under the construction mortgage have been enforced by a court of superior jurisdiction, and the Plaintiffs had the opportunity in that suit to challenge or did challenge the enforcement.

[644] I do not challenge the accuracy of the authorities upon which Billes relies. Moreover, I specifically agree with the conclusion in the last paragraph. Indeed, those are some of the issues to which I find that the doctrine applies.

[645] However, the issues being advanced in the current litigation, namely breach of fiduciary duty, oppressive conduct, and the Derivative Action are separate and distinct causes of action, differing materially from those raised in the Manitoba foreclosure litigation. The Manitoba

action, and any principle of *res judicata* or issue estoppel arising therefrom, certainly does not affect the oppression and Derivative actions, because the same issues, or "*same subject of litigation*" were not determined in the Manitoba actions. The Manitoba action only dealt with the foreclosure on security pledged through the Kingswood entities: *Hall* v. *Hall and Feed & Grain Limited* (1958), 15 D.L.R. (2d) 638 (Alta. C.A.); *Evin's Contracting Ltd.* v. *Bank of Montreal* (1987), 20 B.C.L.R (2d) 57 (B.C.S.C.); *Town of Grandview* v. *Doering*, [1976] 2 S.C.R. 621, and undoubtedly others, relying on *Henderson* v. *Henderson*, [1843-60] All E.R. Rep. 378; *Pearlman* v. *Winnipeg (City)* (1982), 18 Man. R. (2d) 328 (C.A.), and *Bank of BC* v. *Singh* (1990), 51 B.C.L.R. (2d) at 273 (C.A.)). Further, these claims in this Court cannot be construed as claims under or through the Kingswood entities.

[646] *Res judicata* and abuse of process may apply in relation to issues that were litigated and finally determined or ought to have been included in the foreclosure proceedings. However, my conclusion on the validity of the Loans and Loan security do not differ from those flowing from the Manitoba litigation. It is thus, unnecessary for me to consider these arguments.

[647] In conclusion, in view of the fact that I have held that the security taken in the Trust and Newmat Loans is valid (notwithstanding that there has been a breach of the USA and the *ABCA*), I need not consider the issue of whether the Manitoba foreclosure is *res judicata* to the challenge by Mason and McAteer. However, insofar as such a decision were to be a prerequisite to even entertaining the issue of the validity of Loans and such security, I would find that the participation of Mason and McAteer in the Manitoba litigation was not such that *res judicata* would result. Nevertheless, on the merits of individual issues which were prime in the Manitoba litigation, there are some, as discussed *supra*, where *res judicata* is determinative.

XII THIRD PARTY CLAIMS

A. Third Party Claims - Liability of Counsel (McAteer, BJ & TM)

[648] This issue was stated in the Outline for Argument as follows in both the McAteer/Kingswood and Mason Actions:

> 2/4. Is BJ liable, as a third party, to any of the Defendants for any reason apart from the above considerations? Why/why not? If so, what are the consequences? If liability is established do they have recourse in this action against any other party? Who? Why?
>
> 3/5. Is TM liable, as a third party, to any of the Defendants for any reason apart from the above considerations? Why/why not? If so, what are the consequences? If liability is established do they have recourse in this action against any other party? Who? Why?

As to Billes' Third Party claim against McAteer in the Mason Action the Outline for Argument stated it thus:

4. As to McAteer, as a third party, under what circumstances and on what grounds is he liable to the Defendants? Why or why not? If so, what are the consequences? If liable does it have recourse in this action against anyone else? Who? Why?

1. McAteer

[649] I find McAteer liable under the Billes Third Party Claim to indemnify Billes for his false representation to Billes that he had, as undertaken, disclosed her interest to Mason and obtained Mason's consent, in a manner which complied with the *ABCA* and the USA.

[650] As noted, *supra*, the allegations of McAteer's misrepresentation against Billes were raised in both the Billes Counterclaim against McAteer in the McAteer/Kingswood Action and in the Billes Third Party claim against McAteer in the Mason Action. I have decided to grant judgment to Billes, in indemnification of her liability to Mason, under the Billes Third Party claim, but in doing so I will discuss the allegations and arguments from both claims.

[651] Billes argued in relation to the Trust Loan:

> It is submitted that the same principles [as applicable to BJ] apply to McAteer, because he acted for Billes and DDL, and undertook to ensure that the proper legal requirements were met. Not only did he fail to provide any warnings to Billes, he misrepresented the existence of proper resolutions in the minute book and made misrepresentations to Whitlock as to the ownership of DDL. As a result of these breaches of duty, he must indemnify Billes for any liability imposed upon her.

[652] Similarly, Billes argued in relation to the Newmat Loan:

> McAteer failed in his duty as Counsel for DDL and Billes, by failing to provide the appropriate warnings and, should the Court find that Mason did not consent ..., then in misrepresenting that he had spoken to Mason or in allowing Billes to believe that she had no objection to the loan, and in providing the Officer's Certificate. As is the case with respect to the Trust loan, if Billes is held liable, then McAteer must indemnify Billes....

[653] I have found that McAteer was not acting for Billes in the capacity as counsel in relation to the Loans, and as such, he was under no duty to warn or advise her with respect to the validity of the Loans or her liability to Mason. This does not, however, preclude liability on the basis of his personal misrepresentation to Billes that he had advised Mason of Billes' conflict and obtained Mason's consent in relation to the Loans.

[654] In order to be actionable, a misrepresentation may be either fraudulent or negligent, the latter comprising a necessary component of the tort of deceit. What distinguishes a fraudulent misrepresentation from a negligent misrepresentation is an absence of honest belief in its truth:

Francis v. *Dingman* (1983), 43 O.R. (2d) 641 (C.A.), (1984), leave to appeal refused, 23 B.L.R. 234n (S.C.C.); P.M. Perell "The Fraud Elements of Deceit and Fraudulent Misrepresentation" (1996) 18 Advocates Q. 23. In light of the facts I have found, specifically, that McAteer falsely represented to Billes that he had told Mason of Billes' conflict position and had obtained Mason's consent to the Loans, I find that McAteer's statements were dishonest, and therefore fraudulent. As these statements depended on his knowledge of his own actions he could not have had any honest belief in the truth of those representations.

[655] In order to rely on a claim for fraudulent misrepresentation it is necessary for the claimant to specifically plead any allegations of fraud and details of any misrepresentations: E. Bullen et al. *Precedents of Pleadings,* 14th ed. (London: Sweet & Maxwell Ltd., 2001) at 816. However, the presence of the actual words "fraud" or "dishonest" is unnecessary so long as the statement of claim sets out allegations, which if proven, are capable of amounting to fraudulent and dishonest conduct on the part of the defendant: *Korte* v. *Deloitte, Haskins and Sells* (1993), 8 Alta. L.R. (3d) 337 (C.A.), leave to appeal dismissed, [1993] S.C.R.; and *Dallas v. Pringle* v. *P.O. Dwyer and The Northern Investment Agency, Ltd.* (1912), 6 D.L.R. 446 (Alta. S.C.).

[656] In her Statement of Defence in the Mason Action, Billes pled in paragraph 11 (see also paragraphs 11 and 32 of the Billes Defence and Counterclaim in the McAteer/Kingswood Action):

> ...Paul McAteer held himself out as an experienced and knowledgeable solicitor who could and would advise Billes (personally and as trustee) with respect to both loans, provided Billes with legal advice on both transactions, undertook to advise Pamela McAteer (Mason) of the proposed loans, the identity of the lenders and their relationship to the other shareholders and directors of Devoncroft, undertook to obtain Pamela McAteer's consent to the loans, and represented to Billes (and thereby the lenders) that he had obtained the consent of Pamela McAteer (Mason) prior to the making of each loan.

[657] Again, I note that no liability attaches to McAteer *qua* Counsel. However, in a personal capacity the allegations would, if proven, amount to fraudulent misrepresentation. I find that those pleadings are sufficient to support a claim of that nature.

[658] In any event, there is another pleading that even more clearly satisfies this requirement. At paragraph 14(i) in her Third Party Claim against McAteer in the Mason Action, Billes specifically alleges:

> 14. In these proceedings, the Plaintiffs claim *inter alia* that the Newmat Loan and the Trust Loan are invalid and unlawful or prohibited by reason of non-compliance with the USA and section 115 of the [*ABCA*].... in the event the Plaintiffs are successful, these Defendants claim indemnity or contribution against ... [McAteer] on the grounds that they were negligent

> and in breach of their duties to these Defendants, the particulars of which are as follows:
>
> (i) in the case of McAteer only, . . .he falsely or negligently represented to ... Billes, that Mason was aware of and had consented to the loans . . .

[659] In my view these allegations disclose a claim for fraudulent misrepresentation. Although the opening paragraph refers to negligence, the subparagraph specifically alleges a false representation which, if proven, would support a claim of fraudulent misrepresentation. I would also note that similar allegations were made in the Third Party Notice against McAteer in the Derivative Action, however, as will be seen, those pleadings need not be considered.

[660] The classic definition of the tort of deceit was set out in *Derry* v. *Peek*, [1886-90] All E.R. Rep. 1 (H.L.). To succeed in an action of deceit a plaintiff must show:

> (a) a false representation or statement was made by the defendant;
> (b) that was knowingly false or made with reckless disregard to the truth or falsity of the representations;
> (c) the defendant must intend to deceive; and
> (d) the misrepresentation must materially induce the plaintiff to act in a manner that results in damage.

[661] As discussed earlier, I have found elements (a) and (b) satisfied in the present case.

[662] The third element, the intent to deceive, is easily satisfied where a knowingly false misrepresentation is made directly to the plaintiff: L.N. Klar, *Tort Law*, 2nd ed. (Toronto: Carswell, 1996) at 495. Perell, *supra*, states at page 27:

> . . . the proof of the element of an intent to deceive is connected to the nature of what the defendant said and the knowledge and position of the parties when the defendant spoke.

[663] In the circumstances, Billes was unaware at the relevant times (prior to October 9, 1992 or later) that McAteer's representations were false. Nor was there any onus upon her to then have made inquiries to confirm the veracity of the representation, as it is not an answer to a claim in deceit that the victim of the fraud could have discovered for herself that the statement was untrue: G.H.L. Fridman, *The Law of Torts in Canada* (Toronto: Carswell, 1990) at 128; and Klar, *supra*, at 497, note 59.

[664] In all of the circumstances, I find that McAteer's intent to deceive Billes is clear. In my view, McAteer's misrepresentations can only be explained by an intent, for whatever motivation, to influence Billes to take a perilous course of action in relation to disclosure of her interest in the Loans. There is no evidence that I find credible to support any other alternative. Indeed,

while there is no way to determine it, one wonders whether the motivation might have been intentional, namely, to use the alleged lack of knowledge, and the resulting lack of disclosure and consent to attempt to avoid enforcement of the Loans in the future.

[665] The fourth and final requirement is that the misrepresentation materially induced the plaintiff to act in a manner that results in damage. The test of materiality is objective: would the statement have induced a reasonable person to act in reliance on it? If so it must then be determined whether the plaintiff actually relied on it. Perell, quotes *Hinchey* v. *Gonda,* [1955] O.W.N. 125 (H.C.) for the proposition that the test of determining materiality is whether the plaintiff's conduct might have been different had the representation not been made.

[666] I find that a reasonable person would have been induced in all the circumstances of this case to believe a personal representation made by a fiancé (who was also a fellow director, officer and shareholder, but, I find, McAteer did not make his representations in any of these capacities) to the effect that he had completed a task that was requested of him. As discussed previously, although her actions in signing the director's resolution might have aroused her suspicion, I find that any such suspicions were quickly and reasonably laid to rest by McAteer's misrepresentations orally and in the Officer's Certificates. More particularly, I find that Billes was so induced. I am satisfied that had the representations not been made, Billes would have taken a different course of action. She is a sophisticated business woman who had retained solicitors in relation to the Loans. She was also aware of the conflict provisions in the USA. She had insisted on, and obtained compliance in the earlier $54,000 loan. On that basis I find that she would have arranged for someone else to provide disclosure to and obtain Mason's consent, or would have done so herself, had she been aware that McAteer had failed to do so. My finding in this regard is also strengthened by the further finding that Billes herself was induced by the representations, otherwise she would have taken these further steps to ensure the validity of the Loans.

[667] The second part of the requirement is that Billes has suffered damage. However, it should also be noted that the damage suffered must flow in the ordinary course of events or in the special circumstances of the case as a direct and natural consequence of the misrepresentation: Fridman, *supra*, Vol. 2, at 129.

[668] Again I have no trouble finding that this requirement is satisfied. Billes' damages, namely her liability to Mason, was a direct and natural consequence of her reliance on McAteer's misrepresentation.

[669] It should be noted, however, that in the prayer for relief in the Counterclaim, Billes merely sought:

> (a) *In the event the Newmat Loan and the Trust Loan are held invalid,* damages ... together with ... interest [Emphasis added.]

[670] I have not held the Newmat or Trust Loans invalid. Rather, I have granted Mason a remedy under the oppression sections of the *ABCA*, based on Billes' failure to disclose her interest in writing to Mason and obtain her shareholder's approval. That possibility was not included in the prayer for relief in the Billes Counterclaim. The answer is that the Court is not limited by the exactitude of a prayer for relief: *Century 21 Real Estate Ltd. and Shtabsky* v. *Reykdal Investments Ltd. and Umisk Farms Ltd.* (1979), 9 Alta. L.R. (2d) 209 (S.C.T.D.); *Alberta (Public Trustee of the Estate of Robert Wallbridge, a dependent adult)* v. *Wallbridge*, [1984] AUD 2212 (Q.B.); and *M.L.E. Industries Ltd.* v. *E.S.T. Investments Ltd.* (1991), 116 A.R. 182 (Master Funduk); and *Calmont Leasing* v. *Kredl* (1995), 165 A.R. 343 at 352 (C.A.).

[671] In any event, there is another pleading which would clearly satisfy any requirement in this regard. Billes' Third Party Notice against McAteer in the Mason Action specifically claims indemnity or contribution against McAteer in respect of any judgement obtained by Mason from Billes.

[672] Damages recoverable in deceit are based on restoring the plaintiff to the position that she would have been in had the representation not been made, not if the statement had been true: S.M. Waddams, *The Law of Damages* (Toronto: Canada Law Book Limited, 1983) at para. 581. Here I find that, had the misrepresentation not been made, Billes would have taken further steps to disclose her interest and obtain Mason's consent and to ensure the validity of the Loans.

[673] Accordingly, I find that the appropriate assessment of damages to Billes on McAteer's liability to her under the Third Party claim against McAteer in the Mason Action is equal to the damages payable by Billes to Mason as a result of her liability under the oppression remedy. In other words, McAteer will be liable to indemnify Billes for the loss she has suffered as a direct result of his fraudulent misrepresentation.

2. BJ & TM

[674] I have stated *supra* that I find that neither BJ nor TM were aware of the USA or Billes' lack of compliance with the USA or the *ABCA*, and were entitled to rely on the indoor management rule, supported by the Officer's Certificates. As such I have found that they are not liable to Billes by her Third Party claims in either of the McAteer/Kingswood and Mason Actions.

[675] I use this section of these Reasons to provide more detailed background and findings to support that conclusion. However, in reading what follows it should be understood that, while BJ and TM are being treated separately in relation to the Trust and Newmat Loans respectively, much of what was argued and my findings could apply to both, subject to some different evidence, *mutatis mutandis.*

a. BJ

[676] McAteer testified that the commitment letters for the Trust Loan (Exhibits 30, 472 and 473) were provided to Desbarats at BJ, but then transferred to Whitlock. However, in his testimony Whitlock stated that he did not understand anyone else being involved from BJ and claimed no knowledge of any prior legal dealings of any of the parties with BJ.

[677] When Whitlock was asked (in chief), for whom he considered himself acting “as this file progressed?”, he responded:

> ... we considered ourselves acting in the role of completing the documentation necessary for this loan transaction, and that it would be the Trust who would be relying on that documentation, and therefore, we would be acting for the Trust. McAteer would be acting for the corporation, DDL, and he would be responsible for the corporate and other matters relating to DDL.
>
> ...
>
> ... we were to deal with Lavery as the trustee, and on the corporate matters, McAteer, and the combination of those two individuals, and then subsequently, as the file progressed in later meetings with Billes, this was again restated and re-emphasized.

[678] Whitlock also testified and I accept this evidence that:

(a) he relied on McAteer and his Officer’s Certificate as McAteer was understood by Whitlock to be very knowledgeable in corporate governance, and loan security and general documentation;
(b) he was not aware of the DDL USA;
(c) McAteer told him he owned 50% of the shares, and that 39% were held for the benefit of his children, but McAteer made no mention of Mason owning any shares or having any role in DDL (Exhibit 471);
(d) Whitlock was in touch with Steinburg regarding registration of Manitoba security, but had no recollection of any discussion with him regarding Billes’ conflicts, or any request by Billes to do so;
(e) while it was normal to get a solicitor’s opinion in addition to an Officer’s Certificate, as McAteer was performing both roles he didn’t get the opinion as it would be redundant;
(f) while he did not normally examine minute books and only did so when a solicitor’s opinion was necessary but not provided, he did not examine the DDL minute book (probably available to him) as a solicitor’s opinion was not necessary here;
(g) he does not recall telling, but he may have told, Billes that the Officer’s Certificate dealt with any concerns she may have had between her roles as a trustee of the Trust and a 50% shareholder of DDL, but there was no reference to any USA; and
(h) Whitlock was at ease regarding conflicts of Billes between the Trust and DDL because both the Trust and DDL were dealing with their own internal governance issues

> and all the parties that he believed to have an interest in DDL, that is all shareholders and directors, were present and executing the documentation.

[679] Billes summarized some of Whitlock’s evidence, and in particular that:

> Billes expressed her concern over conflict issues in her role as a Trustee and an officer of DDL.
>
> He did no corporate search of DDL; and made no inquiries as to the existence of a USA.

[680] Mason also summarized some of the evidence of Whitlock, some of which explained the starkness of Billes’ recount of same, and I accept the following therefrom:

> Billes did not want to sign the Officer's Certificate out of concern about conflict issues as she was a director and officer, and a shareholder of DDL as well as a trustee of the Trust. Billes did not raise a concern about her conflict position as a result of the Unanimous Shareholders Agreement.
>
> ...
>
> Whitlock received instructions from Lavery to remove Billes’ name from the Officer's Certificate.

[681] BJ argued:

> ... consistent with the indoor management rules of corporate law, Whitlock relied upon the Officer’s Certificate of McAteer (Exhibit 39), who was also corporate counsel for DDL acting on the Loan, wherein he opined and certified that DDL was not bound by any USA which would in any way hinder or restrict the powers of the DDL or the officers of the DDL to authorize, execute and deliver the Debenture. This Certificate, coming from counsel, was equivalent to (indeed stronger) than an opinion from borrower's counsel.
>
> ...
>
> Whitlock gave evidence that his practice in acting for lenders was to rely on the indoor management rule for the purposes of ensuring that the borrower had complied with all internal corporate requirements....
>
> ...
>
> ... the evidence does not enable this Court to conclude that Whitlock failed to exercise reasonable care by relying on a statement made in writing by a very

> experienced counsel, intimately familiar with the transaction and acting as ... an officer and director of the borrower....
>
> ... The operative question as to whether it is reasonable to rely upon an Officer's Certificate, particularly the one granted in the circumstances, is not addressed [by Billes] and the inference that there was a shortcoming is not supported with fact or legal authority.

To the extent of this quote, I agree.

[682] BJ noted that *Billes et al.*, the claimants against the Third Parties, never adduced any expert evidence to the effect that the legal services provided failed to meet an appropriate standard. As it relates to the Trust and BJ, BJ argued further that:

> To the contrary, the evidence of Whitlock is to the effect that he followed his usual practice which he believed to be consistent with indoor management rules of corporate law. That opinion and judgment of Whitlock was not contradicted.

[683] The above evidence and arguments relative to Whitlock's knowledge and action, with which I agree, cause me to conclude that BJ would bear no liability if the Loans had been found invalid, and that BJ is not liable to indemnify Billes for her oppression liability to Mason.

[684] I make these findings notwithstanding conflicts within the BJ firm *vis-a-vis* DDL, McAteer and Mason over time. The evidence on this includes:

> (a) Desbarats acted on behalf of DDL (see the letter of Mason of October 12, 1992 (Exhibit 137), where she says she will contact him as "the company's counsel at BJ", as to the identity of the solicitor she was appointing to represent herself following the meeting with Sali on October 9, 1992);
> (b) BJ prepared the USA - as such, the firm of BJ had the knowledge, and as such Whitlock had the means to knowledge, although not actual knowledge, of the existence of the USA and its terms;
> (c) after it became apparent, on or about August 10, 1992, that Sali had been retained (Exhibit 117), Sali wrote to McAteer on August 11, 1992 (Exhibit 119), and there was communication between TM, Sali and McAteer (Exhibits 122 and 125) about conflicts. McAteer testified he met with Desbarats in late August 1992 and wrote to Desbarats on September 11, 1992 (Exhibit 126) outlining the conflicts and potential conflicts, and then requesting:
>
>> I therefore need to confirm that your firm is DDL's lawyers as it has been involved in all aspects of the formation of DDL, preparation of Partnership agreements and lately with the completion of the Unanimous Shareholders Agreement....

TM brought this correspondence directly to the attention of Sali on September 23, 1992 (Exhibit 128). By letter dated September 25, 1992 to TM (Exhibit 129), Sali denied knowledge of the latter and added:

> I can say that I have spoken to Desbarats on more than one occasion respecting this matter and have advised him that the present differences are completely unrelated to any professional services he may have provided to Billes, McAteer or DDL.[35] I do not intend to play a "restricted role"....

and invited McAteer to set out any objection to BJ acting, which McAteer does, attacking the adversarial position, on September 29, 1992 (Exhibit 134);

(d) McAteer again wrote Desbarats and Whitlock on November 16, 1992 (Exhibit 149) to complain about the BJ conflicts, as does TM on November 17, 1992 (Exhibit 150) and Trawick on November 18, 1992 (Exhibit 158) -- these letters followed Sali's proposal of an Officer's Certificate ["estoppel certificate"] on November 5, 1992 (Exhibit 143), to provide comfort to the Lenders;
(e) Desbarats responded to McAteer on November 19, 1992 (Exhibit 159), stating that:

> I had always understood from [Sali] that we would not act in any legal proceedings in connection with these matters because of our past representation of you, Mason and DDL and our involvement in the financings.
>
> [Sali] assures me that Pitblado & Hoskins is not acting on instructions or advice from him or any other member of our firm, but rather on direct instructions from their client, whoever that may be; and

(f) Sali, in testimony, confirmed that BJ had been retained by both McAteer and Mason in the past, including the purchase by Billes of an interest in DDL.

[685] I find Sali's alleged assurances to Desbarats unconvincing. It appears clear to the Court that Sali, while not on record in any "legal proceedings", was acting for Billes and the Lenders in the dispute leading up to the litigation, and, while he may not have formally "instructed" Pitblado (as he asserts in his letter to TM of November 18, 1992 - Exhibit 157), it appears he was actively involved in introducing Billes and the Lenders to Pitblado (TM was of this view as set out in the similar letters to Pitblado on November 17, 1992 - Exhibits 150 -151). Sali also addresses this issue in his letter of November 20, 1992 (Exhibit 160) in response to TM's letter of November 19, 1992.

[35] On the contrary, I find them completely related, as McAteer points out clearly in Exhibit 134.

[686] Notwithstanding this background, and the fact that it was Desbarats who introduced McAteer to Whitlock, I accept Whitlock's evidence that, at the time of the Trust Loan, he was not aware of any professional work having been done for any of DDL, McAteer, Mason or Billes. Desbarats, who didn't testify, was obviously not so innocent. Nevertheless, it appeared that the "bamboo curtain" was quite impervious.

[687] BJ should be embarrassed by the fact that, notwithstanding BJ had also been (1) retained by McAteer to perform legal work, including the incorporation of DDL and the formation of the partnerships, and (2) Desbarats acted for DDL, McAteer and Mason on the sale of shares to Billes, and for those three on the USA, Sali felt it open to him to act for Billes, in quite an aggressive manner against McAteer (a lawyer representing himself) and Mason (unrepresented) in a meeting on October 9, 1992, to discuss the financial problems of DDL. Mason's letter of October 12, 1992 to McAteer (Exhibit 137) called it "aggressive and hostile behaviour".

[688] In the result BJ bears no liability.

b. TM

[689] I have addressed the question of who TM was acting for and Marshall's credibility, *supra*. I now turn to TM's knowledge of Billes' conflict and TM's role relevant thereto.

[690] As to TM's knowledge of Billes' interests, in cross by TM, the following exchange with McAteer took place:

> Q Now, sir, at no time was TM ever given any information by you that was inconsistent with the facts contained in the certificate or the resolution, Exhibits 76 and 77, correct?
> A The only -- the only matter that was raised, and I recall specifically asking David to talk to Newmat about Martha's control. Other than that, no, we had two directors, we'd completed a transaction, authorized me as president to do all the documents, and that's what was happening. So I don't recall giving him any other instructions relative to that.
>
> Q Well, and further, you gave him no information that was inconsistent with Exhibits 76 and 77, correct?
> A I don't believe so.

[691] On September 30, 1991, Marshall was informed by Newal and Lavery that Newmat was "not controlled by [Billes], but she has a position in it" (Exhibit 448). He knew Billes was a director of DDL, but was not aware at the time of the Loan that Billes was a director of Newmat. He did not have the DDL minute book, nor was he ever told of the DDL USA. He relied on the Officer's Certificate associated with the Trust Loan, and no one ever advised him that the Trust Loan Officer's Certificate was inaccurate. On January 6, 1992, he met with

McAteer in relation to execution of the Newmat Loan documentation, and the documents, including the Officer's Certificate (Exhibit 77), were reviewed and executed by McAteer.

[692] I accept the evidence of Marshall that McAteer agreed to attend to DDL’s “corporate governance” issues - the internal function of meeting bylaws, shareholder agreements, and statutory requirements to permit the lawful authorization and execution of documents by DDL. Moreover, I find that McAteer at no time gave TM any information that was inconsistent with the facts contained in the Officer’s Certificate. Equally, I accept the arguments of TM that:

> (a) Billes gave evidence that while she was aware of the facts and the possible issue [of conflict], she did not speak with Marshall, rather she was relying on others [McAteer] to raise the issue with Marshall;
> (b) the evidence is that, while Lavery and Newel were aware of facts which might give rise to a conflict issue or a potential conflict issue, they neither provided TM with information which would signal such an issue nor did they request TM to address the issue;
> (c) Lavery testified that he felt no obligation to deal with a potential conflict issue ... [and f]urther, he understood that Billes was relying on McAteer to address the issue [as I have found he undertook to do]; and
> (d) Newel testified that he never raised the issue with Marshall and that he never advised Billes that he had raised and addressed the conflict issue with Marshall.

[693] In the result, I agree that no information was provided to TM “about the existence of the DDL USA or particulars of Billes' involvement in Newmat” to put it on inquiry to do anything further than it did. Accordingly, TM is entitled to rely on the Officer’s Certificate, as “[a]t no time was TM given any information to contradict the information in the Officer's Certificate”.

[694] I find further that Newmat relied upon TM, in that there were no advances until October 10, 1991, the date of the execution of the documentation. Although there is no evidence on the timing of the first advance on that date (Exhibit 382), in relation to the time of the execution of the documentation, it is to be inferred that the advance was made after one of two calls by Marshall to Newal when he confirmed the execution. There is no evidence to the contrary.

[695] Moreover, I do not find that, in all the circumstances, Marshall or TM breached any standard of care of a solicitor in relying on McAteer’s Officer’s Certificate and entrusting to him the corporate governance issues. More specifically, I do not find that TM was negligent in the circumstances not to conduct corporate searches, make investigations as to the existence of a USA, or to pursue an investigation as to the compliance with section 115 of the *ABCA*. The obtaining of the Officer’s Certificate is the answer to all these requirements.

[696] With respect to BJ and TM, the arguments of Billes were most specifically articulated in relation to Newmat. Generally, the same arguments would apply to the Trust, *mutatis mutandis*,

noting that the issue of the limited retainer of TM was more in focus in Billes' argument (but not in my findings) than was the case with BJ. Billes argued:

> If there is invalidity which can be asserted against Newmat ... (which is not admitted but denied), any loss flowing therefrom ought to be indemnified by TM.
>
> The legal principles applicable to the obligation of the solicitor, are set forth in our submissions concerning the Trust loan and BJ, *supra*. The same apply to TM.
>
> TM acted for Newmat and owed Newmat a duty to warn it of risk with respect to the validity of the loan security or any course of action respecting the advance on the loan which was known or ought to have been known by TM....
>
> Because TM failed to warn Newmat, failed to perceive any issues of conflict of interest, and failed to respond to any concerns over conflict of interest, it failed in its duty to Newmat....

Billes also relied on A.M. Dugdale & K.M. Stanton, *Professional Negligence,* 3rd (London: Butterworths, 1998) at para. 17.36-17.42 as authority for the proposition that a firm's primary task in connection with the execution of a loan and security documentation is to ensure the lender obtains good and enforceable security.

[697] In response, TM argued that it has no liability on the following bases: no duty was owed to Newmat or alternatively there was a limited duty in relation to the collateral security; no duty was breached; and no causal link existed between any breach and the claim being advanced.

[698] In response, simply put, I find that TM was retained to protect Newmat's interests and, as such, had a duty to Newmat. However, I find further that TM did not breach that duty on the facts before me. Having found no liability, I need not address the final argument on linkage, which relates to Newmat making advances directly and without the reliance on the registration of security.

[699] TM cited *Spence* v. *Bell*, *supra*; *Midland Bank PLC* v. *Messrs. Cox McQueen (a firm)*, *supra*; *Feschuk* v. *Hudema* (1994), 126 Sask. R. 26 (Q.B.); and *Sinclair* v. *Smith* (1981), 41 B.C.L.R. 374 (S.C.) for the proposition that a solicitor's duty must be determined by having regard to the subject retainer and the solicitor/client relationship. It cites as well *Melnychuk v. Ronaghan* (1999), 237 A.R 110 (C.A.), and *Roynat Inc.* v. *Dunwoody & Company and Canadian Imperial Bank of Commerce* (unreported) July 12, 1996 (B.C.S.C.) as authority for the proposition that a solicitor is not under a duty to warn of things already known to the client.

[700] As to the retainer by TM, I have discussed this above. As to the duty that follows, little further need be said other than referencing *Central Trust* v. *Rafuse* at 211-12:

> The fact that the capacity of a corporation to borrow and give security may be limited or subjected to certain conditions by the provisions of the applicable *Companies Act* is such basic knowledge that a reasonably competent solicitor must be held to possess it, whether he is a general practitioner or a specialist. It is a knowledge which a solicitor who undertakes to do the legal work to obtain ... security from a corporation must possess, and with it *there is a duty to exercise reasonable care and skill to ascertain by an examination of the relevant legislation what limits or conditions it imposes upon the capacity of a corporation to give security*. [Emphasis added.]

In my view, this would place on a solicitor the duty to be aware of issues of conflict of interest at common law, by statute or under a unanimous shareholders agreement. Where that duty is combined with a knowledge of facts creating a conflict, liability might flow from any loss flowing from the conflict.

[701] I find that the fact that it was agreed between Marshall of TM and McAteer that the latter was to deal with matters of corporate governance *vis-à-vis* DDL (as Spence was and did *vis-à-vis* Newmat), and therefore in that sense limited the TM retainer, does not absolve TM of the duty to make inquires and to obtain assurances that those matters were attended to. As it relates to McAteer, TM (as did BJ) did so by requiring the execution of, and relying upon, the Officer's Certificate. This was done by TM without knowledge, or any reason to believe, that it was inaccurate. The same also applied to Whitlock *vis-à-vis* the responsibility of BJ relevant to the Trust Loan. In each case such reliance, and lack of need to make further enquiry, was reasonable in my view. In this latter regard, I also agree with the argument of TM that "[g]iven McAteer's involvement in and understanding of the complex DDL arrangements, it was reasonable for TM to rely on him". The same also applies to BJ.

[702] As to whether there was a breach of that duty, as I noted *supra*, the onus is on Billes *et al.* to establish that: the solicitors, knowing of a real or alleged material interest or provisions of a USA that required special acts of compliance, failed to warn them of the risk involved, and had they been properly warned or advised of the risk involved in a course of action, they would probably have taken a different course of action.

[703] In this regard, TM relied upon W.M. Estey, *Legal Opinions in Commercial Transactions*, 2nd ed. (Vancouver: Butterworths, 1997), at 127-28, for the presumption of regularity as it relates to authorizing minutes and the like:

> ... the consensus, and the generally accepted custom and practice among experienced commercial lawyers, seems to be that *all appropriate formalities*, including the election of directors, the appointment of officers, and the convening and holding of meetings, *were duly complied with unless opining counsel has actual knowledge to the contrary*. This, in effect, constitutes another manifestation of the so-called presumption of regularity .... As a result, *most commercial lawyers take the position that it is not necessary to conduct a full*

> *minute book search to confirm that all necessary corporate formalities, including the proper election of directors, were duly complied with for purposes of the due authorization opinion. Rather, they consider it appropriate to rely upon a copy of the relevant directors' resolution duly certified by the secretary of the corporation or other responsible officer with knowledge of the facts*. The certification in this instance would normally recite the fact that the meeting of directors was duly called, a quorum was present throughout, the resolution was duly passed by the required majority, and the resolution remains in full force and effect unamended. *The custom and practice of experienced commercial lawyers is that it is appropriate for an opining solicitor to rely on such a certificate, absent any knowledge to the contrary.* [Emphasis added.]

[704] TM also relied on the same authority, at 261, in reference to the duty regarding conflicts:

> An interesting question ... is whether the opinion giver is obliged to make inquiries to determine whether any of the directors on the board of the corporation which approved the agreement in question may have had a conflict of interest, or whether the opinion giver is only required to deal with those conflicts which become apparent during the course of the transaction. *Most lawyers adopt the latter view: that is, that it is not incumbent on them to make investigations but if a conflict situation does come to light it must be dealt with. This is reflective of the view taken by most counsel that they have no positive duty to inquire as to whether directors have satisfied their fiduciary obligations, nor as to whether there are any vitiating factors ... which may affect the enforceability of an agreement*. Thus, this matter as well should be dealt with by the opinion giver only if he or she has actual knowledge of it. [Emphasis added.]

[705] TM also relied on Estey, citing *Ormindale Holdings Ltd.* v. *Ray, Wolfe, Connell, Lightbody & Reynolds* (1982), 36 B.C.L.R. 378 (B.C.C.A.) for the principle that the standard may be lower for a sophisticated client. However, I need not be concerned about the standard, as I find both BJ and TM met the higher standard.

[706] Finally, TM also relied specifically on a number of sections of the *ABCA* that provide statutory authority for TM’s handling of the Newmat Loan (the same considerations would apply to BJ’s handling of the Trust Loan, *mutatis mutandis*). The most helpful of the provisions, and implications argued to follow, are:

Section:	117 - Every director shall comply with the *ABCA*, regulations, articles, by laws and unanimous shareholder agreement.
Implication:	Given this statutory duty, it was reasonable for TM to presume that Billes and McAteer would comply with the Act, regulations, articles, by laws and USA.

Section: 98.1 - Unless prohibited by the articles or by laws or unanimous shareholder agreement, the directors may without the authorization of shareholders, borrow money

Implication: It was reasonable for TM to believe that McAteer and Billes could borrow money from Newmat.

Section: 250 - A certificate issued on behalf of a corporation may be signed by a director of the company. That certificate is in the absence of evidence to the contrary, proof of the facts so certified.[36]

Implication: TM could reasonably rely on the Officer's Certificate dated January 6, 1992, the Resolution of Directors passed on October 10, 1991, certified on January 6, 1992. [In relation to the Trust this would be the March 21, 1991 Officer's Certificate executed by McAteer.]

Section: 18 - A corporation or person claiming through a corporation may not assert against a person dealing with the corporation that the articles, by-laws or USA have not been complied with, or that a person held out by the corporation does not have the power to perform a duty which might reasonably be expected to be performed by the director, unless the person has or ought to have knowledge of the those facts at the relevant time.

Implication: Since TM was not in possession of the corporate records and was never advised of contrary facts, it was entitled to rely on the Officer’s Certificate and was not obliged to make inquiries of each of the directors and shareholders in relation to the Newmat loan.

With the limitation of the purpose of s.250, I agree with the implications argued in the absence of any evidence to the contrary.

[707] I find that neither Counsel from TM or BJ, acting on behalf of Newmat and the Trust during the Loan transactions, had any knowledge of the irregularities relating to the Loans. Specifically, I find that neither had notice of the USA or of any conflicting interest of Mason. In discovery McAteer acknowledged under oath that these Counsel were not advised of the USA (960/5 - 961/7), and even at trial he could not testify that he had advised TM of the USA.

[708] Only McAteer had (see s.18 *ABCA*) any knowledge of Billes’ failure to meet the requirements of the USA or the statutory provisions to the same effect.

3. Conclusion

[36] Note, however, that a certificate under s.250(1) is in contemplation of being used for the purpose of introduction into evidence under s.250(2)

[709] I find that BJ, as Whitlock clearly acknowledged, acted on behalf of the Trust in providing legal services for the security obtained by the Trust from DDL.

[710] I find that TM, notwithstanding Marshall's claims to the contrary, acted on behalf of Newmat in providing legal services for the security obtained by the Trust from DDL.

[711] However, I find that neither Whitlock nor Marshall had knowledge of, nor were reckless or wilfully blind to knowledge of, the USA, or any irregularity in the internal approval of DDL, and as such, were entitled to rely upon the indoor management rule and the respective Officer's Certificate of McAteer. As such, even if I had found (as I do not) the Trust Loan or Newmat Loan security unenforceable, there would not have been judgment by the Trust against BJ or by Newmat against TM. In short, having regard to all of the circumstances, I find that BJ and TM exercised the standard of care of reasonably competent lawyers.

XIII. THE DERIVATIVE ACTION

[712] I must say at the outset that the Derivative Action, prosecuted by Mason on behalf of DDL, was not prosecuted very actively in the evidence or argument. I believe this is so because it was realized that no useful benefit would be obtained by DDL and Mason's recovery could be as easily, or more easily, accomplished under the oppression remedy. I agree with this rationale and that result has turned out to be the case. Accordingly, I will be quite brief in my findings and reasons in this section.

[713] For a good historical background on derivative actions (and, indeed, oppression actions) in Alberta, see: *First Edmonton* (Q.B.), *supra.*

[714] The nature of the Derivative Action has been described above. Specific alleged breaches include: (1) McAteer executing false Officer's Certificates; (2) McAteer and Billes failing to manage the affairs of DDL and avoid a business failure; and (3) McAteer and Billes failing to act in the best interests of DDL by (a) failing to resolve the issues between them, and (b) on the evidence, taking personal benefits from the $200,000 Loan. Based on the causes of action claimed, it is alleged that DDL suffered damages. The relief sought for this and other alleged breaches include, as against each of Billes and McAteer: damages; aggravated or punitive damages; "an order directing that any amount adjudged payable by the Defendants in this action be paid, in whole or in part, directly to Mason ... instead of DDL"; and solicitor-client or party-party costs.

[715] To telescope ahead, on the evidence, I make the following findings in relation to these 3 claims: (1) true and actionable, but no damages result to DDL ; (2) and (3)(a) generally true in fact, but not actionable in law; and (3)(b) *prima facie* actionable and for which I would have found both Billes and McAteer liable to DDL for damages except that the liability is barred by the statute of limitations.

A. Limitations Issues

[716] A tolling agreement with respect to this Derivative Action was entered into by the parties, and confirmed by the Order of McIntyre J., which established that this action was deemed to date from November 24, 1998 for limitation purposes. This means that any cause of action discoverable prior to November 23, 1992 (midnight) is outside the limitation period. Accordingly, as Mason submits, only causes of action which arose after November 24, 1992 are properly to be considered in determining the liability of Billes and McAteer in the Derivative Action.

[717] Accordingly, the first issue that arises is whether these claims are within the limitation period for this action deemed commenced as of November 24, 1998. I will also deal with other limitation issues in passing.

[718] The *Limitation of Actions Act*, R.S.A. 1980, c. L-15 (which is the relevant limitations statute here) provided:

> 4(1) The following actions shall be commenced within and not after the time respectively hereinafter mentioned:
>
> (c) actions
> ...
>
> (ii) for an account or for not accounting,
> ...
> within six years after the cause of action arose;
>
> ...
>
> (e) actions grounded on accident, mistake or *other equitable ground of relief not hereinbefore specifically dealt with*, within six years from the *discovery of the cause of action*;
>
> ...
>
> (g) any other action not in this Act or any other Act specifically provided for, within six years after the cause of action therein arose. [Emphasis added.]

[719] As Mason argued, claims based on the breach of a fiduciary duty of a director are equitable claims under subsection (e) and accordingly the applicable limitation period is 6 years: *Calmont Leasing Ltd.* v. *Kredl* (1993), 142 A.R. 81 (Q.B), aff'd *Calmont Leasing Ltd.* v. *Kredl* (1995), 165 A.R 343 (C.A.). I would note that the limitation period for an oppression action would also be six years in accordance with subsection (g): *Jaska* v. *Jaska* (1999), 141 D.L.R. (4th) 385 (Man. C.A.).

[720] In relation to derivative actions the British Columbia Supreme Court found in *Park* v. *Sunrich Processors Ltd.*, [1999] B.C.J. No. 807, (S.C.), online: QL (BCJ) that the six year limitation set out in the basket clause of the applicable legislation in that case (s.4(g) here) applied. I find that is also the applicable limitation here, subject to discoverability. Consequently, whether the applicable limitation period is based on subsection (g) or (e), it is six years in either case. Accordingly, recovery for any cause of action arising or discoverable prior to November 23, 1992 is precluded.

[721] Mason argued the limitations issue in oral argument in this way:

> The record would indicate that there were three actions brought by Mason. The first action was filed in December of 1992 and that is the Originating Notice of Motion ... that pleads the oppressive conduct and seeks relief....
>
> The second action that is commenced on behalf of Mason is an action commenced by the Rogers firm [March 20, 1977] and I believe ... [oppression] is specifically referred to in that action -- or in the record.
>
> The third action ...[is] the Derivative Action. There is no doubt the Derivative Action does claim oppressive conduct in addition; but it's an action brought for and on behalf of DDL against the various parties. The other actions are brought specifically in the name of Mason.
>
> So the Derivative Action ... according to the tolling agreement, it's commenced in November of 1998, and ... a six-year limitation period would ... apply to that action. So that causes that expired six years prior to the date of the tolling agreement are gone. The limitation period applies. The causes of action that exist following that, following November '92, those are caught in the derivative action then.
>
> ...
>
> THE COURT: So you're saying insofar as the original granting of the loans prior to November '92, they are caught by your [Originating] Notice of Motion pleading.
>
> MR. DAVISON: Correct.
>
> THE COURT: For limitation purposes.
>
> MR. DAVISON: Correct.

[722] As Mason had not discovered the material facts upon which she based her claims for oppression and breach of fiduciary duty until the meeting with Sali on October 9, 1992, or later, those claims are well within the 6 year limitation periods under the Originating Notice of Motion and the Statement of Claim in the Mason Action. Accordingly, while the allegations in the Derivative Action against Billes and McAteer may be troubled by the limitation date, the allegations in the Mason Action were clearly made within the limitation period.

[723] The issues that form the substance of the Derivative Action include the Officer's Certificates and the $200,000 Loan, which were a part of the Loans to DDL from the Trust and Newmat and the creation and issuance of security in relation thereto. The latter, the Newmat Loan, was executed on October 10, 1991 and January 6, 1992. Accordingly, the limitation period, subject to discoverability, expired as of January 6, 1998 at the latest. The discoverability principle was set out in *Central Trust* v. *Rafuse*, where Le Dain J. stated at 224:

> I am thus of the view that the judgment of the majority in *Kamloops [(City) v. Nielsen,* [1984] 2 S.C.R. 2] laid down a general rule that a cause of action arises for purposes of a limitation period when the material facts on which it is based have become discovered or ought to have been discovered by the plaintiff by the exercise of reasonable diligence...

[724] DDL can only bring action through its officers, directors and shareholders. McAteer and Billes certainly are not going to bring action, through DDL, against themselves: *Park* v. *Sunrich Processors Ltd.*, at para. 26, which cites *Drove* v. *Mansvelt*, [1998] B.C.J. No. 497, (B.C.S.C.), online: QL (BCJ) for the proposition that "to expect a director to sanction an action against himself is unrealistic". That only leaves Mason to do so, and the evidence that I accept is that she had no knowledge of the Loans, nor could she reasonably have had such knowledge, until after the meeting with Sali on October 9, 1992 (see paras. 18 and 26 of the Statement of Claim in the Mason Action).

[725] Following the Sali meeting Mason would have been in possession of all of the material facts. Accordingly, the limitation period would have begun to run on or shortly after October 9th, 1992, expiring on or shortly after October 9, 1998. Thus, as Mason would have had, or been able to discover, the knowledge of the Officer's Certificates and the $200,000 Loan from DDL on or before November 23, 1992, and the Derivative Action was deemed to have been commenced as of November 24, 1998, I find that these claims are outside the limitation date and, as such, are dismissed.

[726] Billes contended that the claims for errors in running the business, or making or calling the Loans after default, arose more than six years prior to November 24, 1998, and are accordingly statute barred. Billes claimed further that any claim by DDL against the Lenders realizing on their security relating to the alleged invalidity of their Loans or security, is also barred, as the time for such action began to run from the date the Loans were executed or perhaps the date of default: *Wavel Ventures Corp.* v. *Constantini*, *supra* at 95. However, the latter is of no consequence in this action, as the Lenders are not parties to the Derivative

Action. Accordingly, the second argument is of no consequence. However, I will elaborate on the first.

[727] It is arguable that any failure of McAteer and Billes in their duty to DDL in relation to running the business, while it commenced at some hard-to-identify earlier time, was continuing for some time. The effective date of the commencement of the Derivative Action of November 24, 1992, was six years and one day after the demand on DDL on November 23, 1992, and therefore one could safely say that any continuing breach of duty had “crystalized” at the earlier date. Accordingly, I find that liability for that would have been barred as at the day the Derivative Action was deemed commenced.

[728] While I find that the causes of action in Derivative Action fail because they are outside the limitation period, I will touch somewhat on the substance.

B. $200,000 Loan

[729] I find that the $200,000 Loan was in the Newmat Loan documentation Mason received on or about October 9, 1992. Mason also had counsel instructed in relation to the Loans prior to November 23, 1992. There being no evidence of lack of actual discovery before that date, I find that the claim against Billes and McAteer in respect of their breach of duty to DDL in using the $200,000 Loan for their own purposes and contrary to DDL’s interests, is statute barred.

[730] If I were to have found this cause of action within the limitation period, I would have concluded that the $200,000 Loan was contrary to the interests of DDL, and in breach of the duties of McAteer and Billes as directors. My finding in that regard is based on the fact that they treated DDL as their own personal domain, contrary to DDL’s interests, and my finding is aided by the following evidence and argument.

[731] Counsel to Billes, Michael Robison, described it this way on October 10, 1991 (Exhibit 377):

> McAteer is of the view that Numat (sp?) has made ... a $200,000 secured loan to Devoncroft.... these funds will permit ... a repayment to you of the $200,000 non-recourse debt thereby making reference to the note academic.
>
> Accordingly, ... you would pay McAteer $224,100 for his interest in the home the components of which are his cash contribution ($19,100), the now repaid funds borrowed from you as a contribution towards the house ($200,000) and his labour ($5,000).

[732] Billes made reference to it in her undated letter of July 1992, to McAteer (Exhibit 107): “DDL is carrying the debt related to the $200,000 payment to you, created when you moved out of 2229". McAteer also described it in reply on July 24, 1992, in one of his last personal letters to Billes before there was a complete break in their business relationship (Exhibit 109):

> You have also referred to the $200,000 paid out to me personally on a number of occasions. This payment was to resolve the personal difficulties arising out of a financial arrangement where we purchased a house in contemplation of marriage. *It is a burden on DDL* that you placed there because you did not wish to go through with an agreement we had in relation to a personal loan by you to me. You also wanted to purchase my half of 2929 Wolfe Street as opposed to selling the house we owned jointly. *We paid the loan back by triggering an early loan repayment from DDL to me and increasing the debt load by $20,000 per year in DDL.*
>
> *The folly of agreeing to such a solution now surfaces*, as we now are dealing with the difficulties created of your unwillingness to live up to a personal commitment. ... *Secondly the loan requires $20,000 to service it. And finally DDL is exposed to additional cost relating to the tax payable on the advances.* [Emphasis added.]

[733] I accept McAteer's evidence that there was no discussion between Billes and him, in the process of negotiating the $200,000 Loan, that it was in the best interests of DDL.

C. Other Breaches Alleged

[734] It is possible for a corporation like DDL to be a complainant under the oppression remedy at section 234 of the *ABCA*, through the definition of "person" in section 231(b)(iii) upon the discretion of the Court. I have not been asked to exercise this discretion. Moreover, DDL was a signatory to the USA, which I find was breached by Billes and McAteer. However, the pleadings in, and the arguments of Mason in respect of, the Derivative Action focussed on breaches by Billes and McAteer of their obligations under section 117 of the *ABCA*. As to oppression by Billes and McAteer against DDL, although the Originating Notice of Motion alleged it and leave to commence the Derivative Action was sought, that was not done until, as I find, after the limitation period expired. Moreover, even within the time limit, except for the $200,000 Loan, I find no actions by Billes and McAteer were oppressive, unfairly prejudicial to, or unfairly disregarded DDL's interests. Accordingly, I would not have granted a remedy to DDL under the oppression provisions.

[735] Thus, I will focus on those alleged breaches/remedies, and not on any oppression remedy in favour of DDL.

[736] The Derivative Action alleges, in paragraphs 19 and 20, breaches of fiduciary and legal duties by McAteer and Billes in permitting DDL to enter into, *inter alia*, the Newmat Loan in breach of, *inter alia*, s. 117 of the *ABCA*. Section 117(1)(a) provides:

> 117(1) Every director and officer of a corporation in exercising his powers and discharging his duties shall

> (a) act honestly and in good faith with a view to the best interests of the corporation...

[737] I do find that McAteer breached his duty under s. 117(1)(a) of the *ABCA* in not acting honestly and in good faith with a view to the best interest of DDL, by signing false Officer's Certificates. I find he was also in breach under s.117(2) in failing to comply with the USA *vis-à-vis* the requirement of a shareholders' resolution for which he took the responsibility, but failed to fulfil. However, that can result in no liability because the limitation period passed even on Mason's knowledge for DDL. However, even if it was within the limitation date there was no loss to DDL because it got the Loans it needed.

[738] In the context of mismanagement, Billes argued:

> Billes can only be found liable for breach of the obligations which she owed to DDL. Billes was neither a director nor officer of the general partners or limited partnerships. As submitted above, those are separate entities with their own existence. McAteer was to be the manager of these projects, as Mason testified. This consideration alone dismisses most of Mason's complaints about mismanagement of the business. It was not Billes' responsibility to manage the projects, either legally, or in terms of the reasonable expectations of the parties.
>
> Further, Billes was entitled to rely upon duly appointed officers including the president and secretary of DDL, and in doing so discharged her obligations.
>
> *Blair* v. *Consolidated Enfield Corp.*, *supra*, at 34-38
>
> The business judgment rule also applies in circumstances as these. In order for the corporation to be managed properly and efficiently, directors must be given wide latitude in their handling of corporate affairs. Absent bad faith or some other corrupt motive, directors are normally not liable for mistakes of judgment whether classified as mistakes of fact or mistakes of law.

I have dealt with *Blair* earlier in these Reasons. In relation to Billes' submissions concerning the business judgment rule, I generally agree.

[739] The authorities relied upon respecting this business judgment rule were *re Smith and Fawcett*, *supra*; *Teck Corp.*, *supra*; *Cramer*, *supra*; *PII Photovision*, *supra*; and *Burland*, *supra*.

[740] Later the Billes argument stated:

> As to the allegation that building the Golf Dome diverted cash and management time away from golf course construction and lot sales, the same submissions apply. Further it is submitted that cash could not be diverted from the golf course (a separate entity), and if it was this was not the responsibility of Billes.

> It was the responsibility of the directors and management of Club GP, which does not include Billes. The same is true of management time.
>
> In further answer to such allegations, Billes was not a director or officer of any of the limited partnerships or general partner.
>
> In further answer to such allegations, each of the participants, Billes, McAteer and Mason, understood that McAteer was to operate and manage the entities. When a request was made in August and later, October of 1992, that he step aside, both McAteer and Mason refused. Billes was not responsible for management or operational decisions.
>
> If the Golf Dome was over budget, this was not the fault of Billes, nor was it any responsibility of DDL as opposed to Kingswood Developments.
>
> Billes was not responsible to provide "leadership" to the Kingswood entities, nor did the parties reasonably expect that she would do so.

Again I generally agree.

[741] Even if the above allegations were within the limitation period, I would dismiss them as not having been within Billes' responsibility. Accordingly, to the extent the actions are arguably within Billes' and actually within McAteer's responsibility, they are not actionable because they are caught by the business judgment rule.

D. Conclusion On Liability

[742] I dismiss all claims within the Derivative Action. As the Defendants are not liable, there is no liability by BJ and TM to Billes on her Third Party claim against them in the Derivative Action.

E. Remedy

[743] Mason noted the relief provisions of s.233 of the *ABCA*, following the derivative action authorization section of 232, and argued, without referencing case authority, as follows:

> In the circumstances of this case, it may be appropriate for the court to order that any amount adjudged payable by Billes and McAteer in the derivative action shall be paid, in whole or in part, directly to Pamela Mason, in trust for her children (as security holders of Devoncroft), instead of to Devoncroft.

[744] In reply, Billes argued:

> Mason's counsel gives no reason as to why it would be appropriate for damages to flow directly to Mason instead of DDL. If DDL has suffered the loss, then the damages should flow to DDL. At that level, the damages first go to the company's creditors, including Newmat. What is left should be shared amongst the shareholders.

[745] Billes conceded that if liability were established for negligent management, the appropriate remedy would be damages. However, she argued that there was no negligence attributable to Billes, and as DDL had no loss (having no value at the material time), there would be no damages to award.

[746] The remedy for any such breaches of duty by Billes and McAteer to DDL would have normally been a judgment in favour of DDL for damages for its loss. However, such a judgment would have been of little use to DDL as it is in receivership, has no assets of value, and was struck off the corporate registry. The result would be that the benefit would go to the Lenders. The Lenders should be entitled to no remedy directly or indirectly from the Derivative Action. A benefit to the Lenders would not be necessary as the Lenders had the security to enforce what they thought adequate for the risk they took when they loaned the money - a risk that materialized. Therefore, there is no justification for, in effect, providing further additional security after the fact when none of DDL, Billes or McAteer had any obligation under these alleged issues to the Lenders. Moreover, this would not have been acceptable as it would, indirectly, benefit Billes, through the Lenders, when it was her and McAteer's wrongful act that resulted in the judgment. Additionally, Mason having recovered the value of her shares through the oppression remedy, has no remaining loss, and recovery by her would be a windfall that would not be equitable. Accordingly, if I had granted damages to DDL it would have been in the sum of $1. Had I granted damages, they would have been against Billes and McAteer, jointly and severally, with no right of contribution between them, in favour of DDL. Otherwise, I believe that no separate remedy is appropriate.

XIV. OTHER ISSUES

[747] I believe there are no other issues that require decision in light of my decisions herein.

[748] However, it would be surprising in litigation with this number of parties, the breadth of pleadings and issues, the volumes of evidence and argument submitted, and, indeed, the length of these Reasons, if there were not an occasional slip or an issue on which a decision was not made. Accordingly, if there are any slips to which Rule 339 applies, or any issue not decided herein that should have been decided and it is proper in law to do so, the parties may return to the Court on consent, or on motion, prior to the entry of the Judgment Roll, to remedy such matters.

XV. INTEREST

[749] I leave it to the parties to calculate the interest to which Mason and Newmat are entitled and include the calculations in the Judgment Roll by agreement, and if they cannot agree, to return to me to determine the calculation. Interest to Mason will be under the *Judgment Interest Act*, S.A. 1984, c. J-0.5. Interest to Newmat against McAteer will be as provided for in the McAteer Guarantee by McAteer to Newmat.

XVI. COSTS

[750] In *Patel*, *supra*, I held that solicitor-client costs are to be awarded in oppression cases, absent compelling circumstances. At para. 63, I said:

> Without reviewing the cases further, but consistent with the rationale in solicitor-clients awards in general (as discussed in *Claudio's* [*Claudios Restaurant Group Inc. v. Calgary (City)* (1993), 147 A.R. 353, additional reasons (1993), 140 A.R. 376 (Q.B.)] and the cases referenced therein), and aided by the reasoning in Naneff (and the cases referenced therein) in the context of a finding of oppression, while costs are always in the discretion of the Court (see, inter alia, *269335 Alberta Ltd. v. Starlite Investments Ltd. and Eimer* (1987), 53 Alta. L.R. (2d) 142 (Q.B. - Rowbotham, J.), I believe that solicitor-client costs should be considered *prima facie* the order of the day, absent compelling circumstances. In this way they are much the same as the similar cost presumption in expropriation cases: *Costello v. Calgary (City)* (1995), 163 A.R. 241, 23 C.C.L.T. (2d) 125, 25 M.P.L.R. (2d) 24 - last page). In this case, on the facts before me, and based on my findings, I specifically find that the Plaintiff should be, *prima facie*, entitled to solicitor-client costs. Such awards of costs are as much available against individual defendants as against corporate defendants: *Starlite* case (above).

[751] TM argued:

> The general rule regarding third party costs is stated in M.M. Orkin, *The Law of Costs*, 2nd ed. (Aurora: Canada Law Book Inc., 1999) at 2-73- 2-74:
>
>> The usual rule is that an unsuccessful plaintiff will not be charged with the costs of the third party on the reasoning that the plaintiff did not sue the third party, did not want him or her in the case and was not responsible for joining the third party.

[752] I find that there is no reason to depart from the *prima facie* and general rules.

XVII. CONCLUSION

[753] In conclusion, I find that the actions of all Plaintiffs in this case, and the actions by Defendants against Third Parties, are dismissed with costs, except for the Mason Action, as against Billes and McAteer only, and the Newmat Counterclaim and the Billes Third Party

claim against McAteer. The victors in each case shall have costs against those opposite in interest, except for costs in the Derivative Action. In the Derivative Action I find that Mason is only liable for incremental steps of the Defendants in the Derivative Action that were over and above those taken in the Mason Action.

[754] In the result, Mason shall have judgment for $440,000, plus interest from March 21, 1991, and solicitor-client costs, jointly and severally against Billes personally and McAteer personally, but not against the Trust or Newmat.

[755] In the Billes Third Party Claim against McAteer, Billes shall have an indemnification judgment for the same amount and solicitor-client costs.

[756] Newmat shall have judgment for $1,950,000 less any credits due plus interest from November 23, 1992 and costs, against McAteer.

[757] All other actions are dismissed with costs.

[758] Costs shall include reasonable and legally permissible disbursements, including the reasonable charges and accounts of expert witnesses who gave evidence at the trial or whose expert reports were served prior to the trial and were contemplated to be called, and were reasonable to be obtained, including, pursuant to Rule 600(1)(a)(ii), the charges made by such persons for investigations and inquiries and assisting in the conduct of the trial.

[759] Except where solicitor-client costs are awarded, all costs are to be taxed, unless otherwise ordered hereafter at any cost hearing, on the basis of Schedule C, Column 5.

[760] All costs will be against the party from which they are entitled in the first instance, subject to any further hearing on the subject of costs.

[761] If I have missed any issue of costs, they will follow the event, unless there are issues of unresolved pre-trial costs, contribution (such as a request for a Sanderson Order), unaccepted settlement proposals, second counsel fees (if any), or any other issue of costs, about which I have no current knowledge, or have received no argument, or have made no direction. In any of these events the parties may speak to any such issue of costs, if necessary, prior to the entry of the Judgment Roll.

HEARD on the 13th day of March to the 31st day of August, 2000.
DATED at Calgary, Alberta this 7th day of November, 2001.

J.C.Q.B.A.
APPENDIX I

AGREED STATEMENT OF FACTS AND DOCUMENTS[37]

References herein to Exhibit Numbers are references to the Agreed Book of Documents.

The parties hereto agree to the following facts:

1 These Statement of Claim proceedings, and a trial of the issues in the Originating Notice proceeding, are tried together pursuant to Order of the Court of Queen's Bench of Alberta dated October 17, 1997 and January 15, 1999. DDL is not represented by counsel pursuant to an Order of the Court of Queen's Bench of Alberta dated May 12, 1999 (See Record, Exhibit A).

2. **Devoncroft Developments Limited ("DDL") corporate information/history**

Prior to Billes' investment April 23, 1990, DDL shareholders were:

Pamela Mason - 20%
Paul McAteer - 20%
Pamela Mason as Trustee for the Children of Pamela Mason and Paul McAteer (namely, Catherine McAteer, Sarah McAteer and Paul William McAteer) - 60%

After the April 23, 1990 investment by Billes, DDL's shareholders were as follows:

Pamela Mason ("Mason") (40%) (claims as trustee for the children of Pamela Mason and Paul McAteer);
Paul McAteer ("McAteer") (10%); and
Martha Billes ("Billes") (50%)

The transaction in 2(b) is reflected in the Agreed Exhibits (Exhibit 9).

At all material times DDL's directors were:

McAteer (appointed September, 1987)
Billes (appointed April 23, 1990)
Mason (appointed September, 1987; resigned effective April 23, 1990)

APPENDIX I

[37] Some changes have been made to make this consistent with the terminology and exhibit references at trial and in these Reasons.

Neither Billes nor McAteer resigned as directors before DDL was struck from the Register of Corporations.

Date and jurisdiction of incorporation of DDL: Alberta, May 12,1987.

Date DDL struck/revived:

DDL was struck by the Registrar of Corporations (Alberta) in November, 1994.

DDL was revived by order formally dated January 19, 1999. (See Record, Exhibit E (1)).

Billes, Mason, and McAteer were parties to a Unanimous Shareholders Agreement ("USA") dated April 23, 1990 (Exhibit 13).

Receivership/bankruptcy

DDL was placed in receivership by private appointment dated November 27, 1992.

DDL was never placed in bankruptcy.

3. **Other Companies or Entities**

Marlore Enterprises Ltd. (“Marlore”)

Marlore’s sole shareholder at all material times was Billes.

The sole director of Malore at all material times was Billes.

Newmat Drilling (Western) Ltd. ("Newmat")

At all material times, Newmat was owned by Marlore (49%), Steven J. Matkaluk (26%) and Larry Newel (25%)

At all material times, the officers and directors of Newmat were:

Billes, director
Newel, director, officer (secretary/treasurer)

Matkaluk, director, officer (President)

2809291 Manitoba Ltd. ("280")

This company was a bare trustee for certain security granted to Newmat described below. At all material times, Newmat owned 280.

At all material times, 280's directors and officers were Newel and Matkaluk

Billog Corporation Ltd.

At all material times, Billog was owned by Owen Billes

At all material times, the officer and director of Billog was Owen Billes

Owen Billes is the son of Billes

Albikin Management Inc. (“Albikin”)

At all material times the Martha Billes Family Trust owned the common shares of Albikin

At all material times, Billes was the officer and director of Albikin

Muriel G. Billes Estate Trust ("Estate Trust")

a true copy of the will creating the Estate Trust is Exhibit 1.

At all material times the trustees of the Estate Trust were Billes, Michael Lavery, C.A. ("Lavery") and Kenneth J. Mann

Devoncroft Developments (Winnipeg) Ltd. ("DDL Winnipeg")

DDL Winnipeg was incorporated pursuant to the *Corporations Act* (Manitoba).

At all material times, DDL Winnipeg's sole director and officer was McAteer.

Home At Last Ltd. (“HAL”)

Prior to 1994, HAL’s shareholders were DDL (50%), 369634 Alberta Ltd. (10%), and 390812 Alberta Ltd. (40%).

390812 Alberta Ltd. was owned and controlled by Daryl Birnie.

4. **Kingswood partnerships/history**

There are two Limited Partnerships involved in these proceedings. Both were created pursuant to the *Partnership Act* (Manitoba). Further details are as follows:

Kingswood Golf & Country Club Limited Partnership ("Club LP").

Club LP’s General Partner was Kingswood Golf & Country Club Ltd. ("Club GP")

Club LP’s Limited Partners after the buy out of Ben Smirnoff’s units were DDL (50%), C. Curtis (7.5%), W. Curtis (7.5%), Pro-Golf Management Ltd. (20%), W.C. Enterprises Ltd. (15%). (Pro-Golf Management Ltd. and was at all material times owned and controlled by G. Curtis and W. Curtis. W.C. Enterprises Ltd. at all material times was owned and controlled by W. Curtis.)

Kingswood Golf & Country Club Developments Limited Partnership ("Developments LP")

Developments LP’s General Partner was Kingswood Golf & Country Club Developments Corporation (“Developments GP”)

Developments LP’s Limited Partner after the buy out of the Murray interests was DDL

True copies of limited partnership agreements are in the Agreed Exhibits(Exhibits 2 and 3).

Details on General Partners

Developments GP and Club GP are Manitoba corporations. They were struck from the Register September 17, 1993. True copies of Manitoba Corporate Registry Certificates of Dissolution are in the Agreed Exhibits (Exhibit 239).

At all material times, McAteer was the sole shareholder of Developments GP and Club GP

At all material times, McAteer was the sole director and an officer of Developments GP.

McAteer, together with Gary Curtis and Wayne Curtis, were at all material times the directors of Club GP, and McAteer was its President.

5. **Billes investment in Devoncroft Developments Limited**

In 1990, Lavery introduced Billes to a potential investment opportunity in DDL.

Lavery was provided a proposal by McAteer.

Billes purchased 50% of DDL for $750,000 on April 23, 1990.

6. **Devoncroft and Kingswood assets**

DDL's assets included:

100% of the Developments LP limited partnership units(after the buy out of the Murray interests)

50% of the Club LP limited partnership units (after the buy out of the Smirnov interests)

50% of the HAL shares

Club LP’s assets included:

the front 9 holes of the golf course in LaSalle, Manitoba a license to golf on the back 9 holes, from Developments LP. This licence was granted by Developments GP to Club GP pursuant to a license agreement dated October 15, 1990. The latter assigned the licence to DDL (Winnipeg) by agreement dated February 22, 1991. DDL (Winnipeg) assigned it to 280 by agreement formally dated February 6, 1992. True copies of the license agreement, and subsequent assignment agreements are in the Agreed Exhibits (Exhibits 23, 31 and 75).

Developments LP's assets included:

the golf dome and operations and lands on which it was situate in Winnipeg, Manitoba.

the Phase I residential lots adjacent to the golf course in La Salle, Manitoba.

the Phase I lots were subdivided into residential lots, and were subject to certain covenants and security in favour of Royal Bank.

title to the back 9 holes of the golf course in La Salle, Manitoba and certain lands (the "Development Lands") contemplated to be subdivided into the Phase II residential lots.

(A) The Development Lands had not been subdivided into lots or from the back 9 holes of golf.

(B) In addition to the Owen Billes and Enns mortgages (described below), the Development Lands and back nine holes of golf were subject to a third mortgage for $85,000 in favour of Taillieu Construction Ltd.

Lands purchased from Terrence Petty, subject to a vendor take back mortgage.

HAL’s major assets were as follows:

HAL owned 4 residential apartment buildings in Red Deer, Alberta

HAL’s liabilities at September 30, 1992 included a mortgage on the building in favour of Toronto Dominion Bank. Balance outstanding was $717,046.

7. **Owen Billes Mortgage**

Owen Billes held a mortgage granted by Developments GP to DDL Winnipeg on July 7, 1990, and subsequently assigned to Owen Billes.

8. **McLarty Loan**

Tess McLarty ("McLarty") (through Lavery) loaned $500,000 to DDL. The loans were made July 3, 1990 ($400,000) and November 1, 1990 ($100,000). Security was a second charge on the Phase I Residential Lots, (subordinate to the Royal Bank of Canada).

9. **Estate Trust Loan**

The Estate Trust loaned $1,200,000 to DDL on March 21, 1991.

Security documents are in the Agreed Exhibits and include:

the debenture (Exhibit 36).

the mortgage and the promissory note (Exhibit 37).

the assignment (Exhibit 37).

the pledge agreement (Exhibit 34).

Role of counsel - Bennett Jones Verchere ("BJV"), a partnership of Barristers and Solicitors carrying on their practice in Alberta and elsewhere, drafted the debenture and its attachments and prepared the mortgage and assignment.

Advances - $1,200,000 was actually advanced.

10. **Newmat Loan**

Newmat advanced $2,100,000 pursuant to a loan agreement dated October 10, 1991 (Exhibit 67) among Newmat, DDL, McAteer, Club GP and Developments GP.

Security documents are in the Agreed Exhibits and include:

debenture from DDL dated October 10, 1991 (Exhibit 68).

promissory notes (Exhibit 66).

undertaking to Newmat from Developments GP dated January 27, 1992 (Exhibit 82).

McAteer guarantee dated October 10, 1991 (Exhibit 63).

mortgage for $1,500,000 from Developments GP to 280 dated January 6, 1992 and registered January 15, 1992 (Exhibit 73).

guarantee from Developments GP dated October 10, 1991 (Exhibit 65).

assignment of the licence to golf the back 9 holes of golf (Exhibit 75).

280 held the mortgage and assignment of license to golf the back nine, in trust for Newmat pursuant to the Agreement of Trust dated January 28, 1992. A true copy is in the Agreed Exhibits (Exhibit 83).

Role of counsel - Taylor McCaffrey, a partnership of Barristers and Solicitors carrying on their practice in Manitoba, drafted the loan agreement and drafted and registered security documents in connection with the loan agreement.

11. **H&T Enns Enterprises Ltd. ("Enns") loan**

Enns took a vendor take back mortgage from Developments GP and Developments LP for $185,000.

This mortgage was on the Development Lands and the back 9 holes of golf. Enns postponed this mortgage to the mortgage held by Owen Billes.

12. **Terrence Petty loan**

Terrence Petty accepted a vendor take back mortgage of $165,000 from Developments LP on the Petty Lands.

13. **Royal Bank loan**

Royal Bank provided a loan facility to Developments LP for $851,000.

The facility was secured by a first mortgage on the Phase I Residential Lots.

14. **Demands November 17 and 23, 1992**

Newmat demanded its loan on November 17, 1992 and again on November 23, 1992 (Exhibits 152, 168, 169, 171)

The Estate Trust demanded its loan on November 23, 1992 (Exhibit 167)

15. **Appointment of Receiver Sill Strueber Fiske Inc. November 27, 1992**

True copies of the Appointment documents are in the Agreed Exhibits (Exhibits 173, 176, 177, 178).

16. **Standstill Agreement and General Security Agreement December 5, 1992**

Billes, the Estate Trust, Newmat, Mason and McAteer entered into an agreement dated December 5, 1992. A true copy is in the Agreed Exhibits (Exhibit 179).

17. **Sill Strueber Fiske Inc. Report March 31, 1993**

Pursuant to the Standstill Agreement, Sill Strueber Fiske Inc. delivered an interim report (Exhibits 180, 181) and a report dated March 31, 1993 (Exhibit 185). Billes, McAteer and Mason each received a copy of the Reports on or about the dates thereof.

18. **Disposition of Certain Assets**

The Phase I residential lots were foreclosed by Royal Bank, not the lenders in this case.

The Development Lands and the back 9 holes of golf were foreclosed by Enns. Enns later paid out the prior Owen Billes mortgage.

19. **Bankruptcy particulars**

Club LP, Club GP, Developments LP and Developments GP gave Notice of Intention to Make a Proposal on May 5, 1993 (Exhibit 196).

KPMG was appointed interim receiver and subsequently receiver by Orders of the Court of Queen's Bench of Manitoba (Exhibits 202, 214, 215).

Club LP, Club GP, Developments LP and Developments GP voluntarily assigned themselves into bankruptcy on May 19, 1993 (Exhibit 261).

20. This Statement of Facts is not exhaustive. For greater certainty, any party may lead evidence to add to or supplement this Statement of Facts.

APPENDIX II
Page 1

OTHER NON-PARTY WITNESSES

- Robin Lee McMahon, a chartered accountant, a partner in Ernst & Young and senior vice-president of Ernst & Young Inc., and a trustee in bankruptcy, acted as Trustee in Bankruptcy for the Kingswood Entities, was called by McAteer

- Larry Braun, and Richard Hester, were chartered accountants practising in that capacity for Deloittes and testified at the request of Billes . regarding accounting services performed for DDL and Kingswood entities

- George Harms, a chartered accountant and Master of Business Administration, who, from September 1991 to August 1992 was Chief Financial Officer for DDL (Exhibit 378), with accounting and operational responsibilities for the Kingwood entities, was called by Billes *et al.*

- Spence, Counsel to Newmat on its loan from Alberta Treasury Branches (ATB) from which it secured funds for the Newmat Loan, was called by Billes *et al*.

- Ian Best, a chartered accountant and a licensed trustee in bankruptcy, at the relevant times with Sill in Winnipeg, was called by Billes *et al.* regarding his and his firm’s role as being appointed (1) on November 27th, 1992, the receiver/manager of DDL the Trust, (2) at that same time, the receiver/manager of DDL by Newmat, (3) at that same time, agent of the mortgagee in possession by Newmat's bare trustee, 280, with respect to the Golf Dome, and (4) in early December, 1992, the monitor/manager of DDL and the Kingswood entities pursuant to the Standstill Agreement, and pursuant to which prepared, *inter alia*, a business report dated March 31, 1993 (Exhibit 186)

- Jay Mustapha, a chartered accountant living and working in Winnipeg, prepared financial statements on the various Kingswood entities, was called by Mason

- Sali, a Barrister and Solicitor with BJ, Counsel for Billes *et al*. in the August - October 1992 period, was called by Billes

- Derek Malcolm, a chartered accountant and associate with Kroll Linquist Avey, with expertise in forensic and investigative accounting, was called by Mason to summarize and analyze information relating to the business of DDL and the Kingswood Entities (Exhibit 333)

- Lorne Siebert, a chartered accountant and chartered business valuator with Clark Valuation Services Ltd., with expertise in determining the fair value of shares in privately held companies and in quantifying financial business damages, was called by Mason to provide comments on the value of the shares of DDL as at April 1990 and March 1991 (Exhibit 351 - rebuttal to Cristall under Exhibit 352)

- Peter McGregor, a real estate appraiser with Anderson Preece & Associates Inc., qualified to practice in Alberta, was called by Billes et al. to give an opinion on the value of Sunnybrook Apartments in Red Deer, being an asset of HAL, as at November 24, 1992 (Exhibit 384)

- E.P. Cooke, a real estate appraiser with Royal LePage Professional Services, qualified to practice in Manitoba, was called by Billes et al. to give an opinion on the value of: (1) lots in the Kingswood development at LaSalle, Manitoba, as at April 1990 and March 1991 (Exhibit 385); (2) the Golf Dome (Exhibit 389); (3) 26 residential lots at LaSalle (Exhibit 388); and (4) development lands at LaSalle (Exhibit 386);

- Peter Miller, a chartered accountant and chartered business valuator with PMG, with expertise in business valuation, was called by Billes . to provide comments as to whether the fair market value of the assets of Kingwood as at November 1992 (Exhibit 390), and as at April 1990 and March 1991 (Exhibit 392), was in excess of the corresponding value as at August 1993

- Jeffrey Cristall, a chartered accountant and chartered business valuator with Meyers Norris Penny, with expertise in the areas of business valuation, and business advice, including valuation of businesses, interpretation of financial statements, financing of business ventures, and fairness and reasonableness of the terms of financing and assessment of the reasonableness of financial projections, was called by Billes . to provide an opinion of value of the shares of DDL as at November 1992, with comments as to value as at April 1990, and the reasonableness of the terms of the Trust and Newmat Loans (Exhibit 393 - rebuttal to Siebert in Exhibit 394)

TAB 5

Ontario Supreme Court
UPM-Kymmene Corp. v. UPM-Kymmene Miramichi Inc.,
Date: 2002-06-20

UPM-Kymmene Corporation, Plaintiff

and

UPM-Kymmene Miramichi Inc., F. Steven Berg, Clifford M. Sifton and Stephen W. Phillips, Defendants

Ontario Superior Court of Justice [Commercial List] Lax J.

Heard: March 4-6, 18-22, 25, April 2-5, 8, 9, 22-24, 2002

Judgment: June 20, 2002

Docket: 99-CL-3536

Ronald G. Slaght, Q.C., Kristen Crain, for Plaintiff

Paul Steep, Lara Teoli, for Defendant, UPM-Kymmene Miramichi Corporation

Earl A. Cherniak, Q.C., George Glezos, for Defendant, F. Steven Berg

***Lax J.*:**

Part I - Overview

[1] This is an oppression remedy case, which examines the conduct of a director who seeks the benefit of a self-interested contract with the corporation he serves. It considers the duties of a Board of Directors when it reviews and approves this kind of contract. It engages the tension between the democratic structure of a corporation and the rights of a shareholder to obtain the court’s intervention if this structure has been compromised. At the heart of it is an Executive Employment Agreement and ancillary Stock Option Grant Agreement (“the Agreement”) between Repap Enterprises Inc. and F. Steven Berg. Mr. Berg was both a director and the Chairman of the Board of Directors of Repap between January and August 1999.

[2] Repap was a Canadian public company in the forest products industry. Mr. Berg is an American lawyer and businessman. He introduced Repap to Third Avenue Funds, a U.S.-based fund, and it became Repap’s largest shareholder and owned 18.7% of its shares when it purchased the block of shares of Paloma Partners on January 27, 1999. Contemporaneously, the three Paloma nominees on the Board of Directors resigned and

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Mr. Berg was appointed a director and Chairman of the Board. He was Repap's largest individual shareholder with 4.3% of its equity.

[3] Mr. Berg's proposed compensation was considered at two Board meetings on February 22, 1999 and March 23, 1999. At the February meeting, the contract was contentious and the directors did not approve it. They decided that it would be prudent to retain an independent consultant to advise them. The Compensation Committee was asked to consider the matter further and report back to the Board. Following the meeting, two directors resigned, and one of them was the Chairman of the Compensation Committee.

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[4] In March, the Board of Directors of Repap was differently constituted. It approved the Agreement on the recommendation of the Compensation Committee, which was also differently constituted. The Agreement provides Mr. Berg with generous payments, benefits and perquisites, including a five-year employment term with renewals, a signing bonus of 25 million shares, a stock option grant of 75 million shares, a market capitalization bonus, immediate pension credit of eight years, executive employee benefits and liberal change of control and termination provisions. Upon execution of the Agreement, Mr. Berg became Chairman and Senior Executive Officer of Repap.

[5] In approving the Agreement, the Board relied in part on an opinion prepared by Margaret Engel, an executive compensation consultant at William M. Mercer ("Mercer"). Due to time constraints imposed on the preparation of the opinion, it was based on "high level observations" and was limited in scope. Ms. Engel believed that Repap had made a strategic decision to bring in Mr. Berg to restructure the company and she was providing advice to it on a non-contentious executive contract. She was not informed that Mr. Berg was unknown to the members of the Board, that his employment contract met with resistance in February, that the Chair of the Compensation Committee had resigned and that management was opposed to it and had questioned its propriety. The Board of Directors was also unaware of these matters.

[6] There was immediate shareholder opposition. The original plaintiff in this action was TD Asset Management Inc. ("TDAM"). It is a wholly owned subsidiary of the Toronto Dominion Bank with responsibility for managing the Bank's equity investments. In 1999, it was Repap's second largest shareholder and owned 13.4% of Repap's shares. Robert MacLellan was TDAM's Executive Vice-President. In April, he became aware of the Agreement and came to

the conclusion that it was not in the interests of Repap's shareholders and something should be done. He enlisted the support of Marty Whitman, the principal of Third Avenue Funds. In June, TDAM led a proxy fight to replace the Board.

[7] Within a few weeks, the outside directors resigned and a new Board was appointed to manage the affairs of Repap. In August, the shareholders elected new directors, but Mr. Berg was not nominated to stand for re-election. As a result, he terminated his employment with Repap under the provisions of the Agreement. In a proceeding commenced in the State of New York, he is claiming U.S. $27 million in benefits and payments due under the Agreement. The New York action is stayed, and this action proceeded to trial.

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[8] The current plaintiff in this action is UPM-Kymmene Corporation ("UPM"). In October 2000, it acquired all of the common shares of Repap, including the shares of TDAM, who assigned its rights in the cause of action. UPM is also plaintiff in its capacity as a shareholder of Repap through an affiliated corporation. The defendant, UPM-Kymmene Miramichi Inc. ("Repap"). is the successor by amalgamation with Repap. The Title of Proceedings has been amended to reflect these changes, but I will refer to the corporate defendant as Repap. The action against Clifford Sifton and Stephen Phillips has been dismissed.

[9] UPM and Repap ask the court to set aside the Agreement but on different grounds. The UPM case is a directors' duties and oppression case. The Repap case is a fraud case. In general terms, I am asked to determine these issues:

1. Did Mr. Berg breach his fiduciary duties to Repap because of the manner in which he negotiated and presented his agreement for approval?

2. Did the Compensation Committee and the Board of Directors of Repap fail in their own obligations to establish a prudent or reasonable process that led to a contract that is not fair and reasonable?

3. Does the Berg Agreement unfairly disregard the interests of Repap's shareholders?

4. Did Mr. Berg knowingly or recklessly make false representations to the Board on which the Board relied to its detriment in approving the Agreement?

5. Does the "business judgment rule" shield the Agreement from judicial scrutiny?

[10] My answer to the first three questions is yes. My answer to questions 4 and 5 is no.

[11] ***The Evidence***

[12] I will review the evidence in some detail, but I wish here to make some general comments on the testimony, which I was fortunate to be able to consider with the benefit of transcript and with the unfailing and admirable assistance of counsel.

[13] I heard testimony from four outside directors: Curtis Jensen, Guy Dufresne, Stephen Phillips and Marshall Cohen. Mr. Jensen was a portfolio manager at Third Avenue and its nominee on the Board. Mr. Dufresne is the President and Chief Executive Officer of Quebec Cartier Mining Company and had been a member of the Repap Board for five or six years. He was the only director to testify who was present at both the February and March Board meetings. Mr. Cohen is an experienced director and former CEO of a major Canadian public corporation, but he was a new Repap director attending his first Board meeting on March 23, 1999, as was Mr. Phillips.

[14] Jonathan Mishkin is an investment banker, and in 1999, he was the head of the Paper and Forest Products Group at Donaldson, Lufkin, Jenrette ("DLJ"). Pierre Raymond is a corporate solicitor at Stikeman Elliot in Montreal. I have already mentioned Margaret Engel of Mercer. These individuals were involved in a more limited way, but their evidence was straightforward and, by and large, uncontraverted. They were entirely credible and reliable witnesses.

[15] Steven Larson was Repap's President and CEO, Michelle Cormier was Chief Financial Officer, and Terry McBride was Vice-President and General Counsel. They were the senior officers of Repap before, during and after Mr. Berg's tenure, and their evidence is obviously important. Marty Whitman and Curtis Jensen of Third Avenue Funds were able to contribute to my understanding of the role they expected Mr. Berg to play in Repap. Mr. Jensen was present for the February Board meeting and prepared a memorandum outlining the Board's opposition, which is a significant document in the trial. Mr. Whitman was present for the March Board meeting when the Agreement was approved. I also found each of these witnesses to be credible and reliable.

[16] The same is true of Robert MacLellan. In addition to the responsibilities he held in 1999 as Executive Vice-President of TDAM, he is currently Chairman of TD Wealth Management. He is an experienced senior executive. I found him to be knowledgeable about

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Repap, informed about executive compensation in the Canadian context, reliable in his analysis of the Agreement, accurate in his assessment of Berg's value to Repap and credible in his evidence about his dealings with Mr. Berg. His testimony was direct, thoughtful and cogent, and I give it considerable weight.

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[17] During the course of Mr. Berg's evidence, objection was raised to some of his testimony on the basis that it contravened the Rule in *Browne v. Dunn* (1893), 6 R. 67 (U.K. H.L.). Initially, I was inclined to give effect to the objections, but as the record will show, I decided that the better course was to hear the evidence and assess it on the basis of weight. Accordingly, I believe that Mr. Berg was given every opportunity and considerable latitude in presenting his story to the court. As his evidence unfolded, the *Browne v. Dunn* issues became much less significant and were not much pressed during argument.

[18] Mr. Berg testified for four days, and I listened carefully to his evidence. I have taken account of the fact that giving testimony is a stressful event and that this is a long lime to be in the witness box. I regret to say that I did not find Mr. Berg to be a credible witness. His evidence was tainted by self-interest. He was unresponsive to questions, both in direct examination and cross-examination. In the face of important documents that were in clear contradiction of his testimony, he made no concessions. He was prone to exaggeration. He was evasive, argumentative and lacking in candour. His evidence is not reliable.

[19] The evidence that was not presented in this case has some importance. Arnold Jacobs, Andrea Rattner and Jeffrey Horwitz are lawyers at Proskauer Rose. Ms. Rattner is an employment specialist and partner at the firm and was centrally involved in the preparation of the Agreement. Mr. Jacobs was the senior lawyer on the Repap file. Both were present for the February and March Board meetings. Mr. Horwitz acted as Secretary to the Board at the March meeting and prepared the Minutes. These individuals could have clarified and given evidence about the nature of their retainer, the nature of the discussion at the Board meetings and whether there ever was an arm's-length negotiation over the Agreement. Although their evidence was available to be called, they were not called to testify.

[20] Mr. Berg testified that he retained Proskauer Rose on behalf of Repap and negotiated the terms of his contract on his own behalf believing that Ms. Rattner was negotiating on behalf of Repap. Mr. Berg relies on the fact that the Proskauer accounts went to Repap and that they reveal an on-going retainer on a variety of matters. This is true. However, it was

Mr. Berg who approved the accounts for payment. They show that Mr. Berg was the only person at Repap with whom Ms. Rattner was communicating in connection with his employment contract.

[21] There is no magic in describing Ms. Rattner as “Repap’s lawyer”. This is merely a descriptive term that does not explain her role in the development of the Agreement. Neither UPM nor Repap assert that she was “Repap’s lawyer”. This is Mr. Berg’s assertion. Normally, proof lies with the party making the assertion.

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[22] Neither the dockets nor the documents support Mr. Berg’s understanding. Ms. Rattner was the witness who could illuminate this important issue. Mr. Berg obtained an Order from the New York court to examine Ms. Rattner, but he elected not to call her. In so doing, he ran the risk that I would draw an adverse inference and I do.[1] I find that had she been called to testify, her evidence would not have supported Mr. Berg’s belief that she was representing Repap in the negotiation of the contract.

[23] *The Board Meetings*

[24] There were four meetings of the Board of Directors of Repap between January and March. The Agreement was discussed at the February 22, 1999 and March 23, 1999 meetings. For the meetings on January 27 and March 8, there are signed Minutes, but there is no formal record of the two most important meetings. The Minutes of the March 23 meeting were never circulated or signed, and Mr. Horwitz’s dockets indicate that he was still working on revisions on April 30. By this time, there was controversy about the Agreement and the process that had led to it. In view of this, I give greater weight to the evidence of those who were present when the contract was approved.

Part II - Factual Analysis

A Brief History of Repap

[25] When Steven Larson joined Repap in the spring of 1997, it had six subsidiaries operating in Canada and the United States. The growth of the company had been very rapid, and it was top-heavy with debt, both at the corporate holding company and at each of the subsidiaries. Paper prices, which tend to be cyclical, were depressed, cash was tight and the

lenders had lost patience. As a result, Repap was forced to dispose of the majority of its assets and convert a significant amount of debt into equity by issuing over 600 million new shares. It was on the debt conversion in 1997 that Paloma Partners emerged as Repap's largest shareholder.

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[26] By the end of 1997, there remained only one operating company, a coated paper mill in Miramichi, New Brunswick, which Repap owned through its wholly owned subsidiary, Repap New Brunswick Inc. As part of this dramatic downsizing, Repap closed its Montreal head office and reduced its staff from 80 to 5 employees. Its senior officers, Larson, Cormier and McBride, re-located to Stamford, Connecticut, where the Repap sales and customer service operations were already headquartered.

[27] Despite the divestitures, cost cutting, and downsizing, Repap still faced challenges. The New Brunswick mill was a state-of-the-art, world-class facility and Repap was the low cost producer with significant market share. However, it remained one of the more highly leveraged forest product companies in the industry with $1.5 billion in debt. In 1998, Mr. Larson and Ms. Cormier successfully undertook a significant refinancing and avoided further conversion of debt and dilution of shareholders' equity. However, as paper prices remained depressed, Repap was a cash-constrained company with too much debt, whose shares were trading at very low levels.

[28] When Mr. Berg entered the picture in January 1999, he believed that Repap was a virtually bankrupt company and unless there was an immediate restructuring of the debt, it had no prospect for survival. He did not think anyone would invest in the company or acquire it unless it was "fixed up".

[29] Not only did Repap survive, but UPM paid a premium for it. Its offer to the shareholders in August 2000 was for approximately twice the market value of the shares. Evidently, UPM saw value in Repap despite its significant debt, which was at approximately the same level then as it was in January 1999. I observe that the UPM offer, which was unsolicited, was made after Mr. Berg departed and at a time when Repap was operating with the same management that was there before he arrived.

Third Avenue Funds

[1] J. Sopinka, S.N. Lederman and A.W. Bryant, *The Law of Evidence in Canada*, 2d ed. (Toronto and Vancouver: Butterworths, 1999) at para.

[30] Third Avenue Funds is a registered investment and mutual fund business based in New York. About fifteen per cent of its portfolio is invested in distressed companies, an area in which Mr. Whitman has special knowledge and experience. Mr. Berg knew Mr. Whitman slightly, but Mr. Whitman was a well-known personality in the business community, the author of two books and, for many years, an Adjunct Professor at the business school at Yale.

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[31] Mr. Berg and Mr. Larson knew one another from a prior business dealing in the mid-1990's while Mr. Larson was still at Domtar Inc. After he joined Repap in 1997, they stayed in touch with each other. By 1998, Mr. Larson had relocated to Stamford, Connecticut, and in May of that year, he and Mr. Berg had dinner together in Greenwich, Connecticut.

[32] Mr. Berg testified that at their dinner, they discussed Repap's problems, and Mr. Berg outlined some ideas he had for addressing them. Shortly after, he met with William Anderson, Repap's Chairman, and in October or November, he introduced Mr. Larson to Huff Asset Management, a potential investor in Repap. Mr. Berg was probably somewhat more active with Repap during this period than Mr. Larson acknowledged and somewhat less active than Mr. Berg claimed. Nothing ultimately turns on this because Mr. Berg agreed that he first contacted Mr. Whitman in late December or early January. Before this, he could have had no expectation that he would play any role in Repap.

[33] In January, Mr. Whitman and Mr. Berg had several discussions about Third Avenue's purchase of the Paloma Block. By then, Mr. Berg was already a Repap shareholder, but Third Avenue would only invest in Repap if Berg increased his personal ownership as Mr. Whitman wanted them to have a "community of interest" as common stock investors. Mr. Whitman believed that there was a window of opportunity of perhaps up to five years to do something with Repap. His understanding was that both he and Mr. Berg would have a role to play in increasing shareholder value and that Mr. Larson would apply his management skills to running the mill and keeping it cost-efficient.

[34] Third Avenue Funds anticipated that Mr. Berg would become Chairman of Repap, performing a non-executive role. This was also Mr. Larson's expectation. Mr. Whitman would not have invested in Repap had he thought that Mr. Berg would displace Mr. Larson as he considered Larson essential to Repap. It was in fact the dissension that developed between

them as a result of the controversy created by Mr. Berg's employment agreement that motivated Mr. Whitman to lend his support to TDAM in the proxy fight.

[35] Mr. Berg testified that he discussed specific compensation he would receive to implement a restructuring plan for Repap, namely—"a load of warrants"—with Mr. Larson at their May dinner and with both Larson and Whitman at a January meeting prior to Third Avenue's investment. He also testified that it was at the January meeting that his role as an executive Chairman was discussed. In direct contradiction, Whitman, Larson and Jensen testified consistently that there was no discussion about Berg's compensation or his role at Repap at any time before Third Avenue made its investment on January 27, 1999.

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[36] It was Mr. Whitman's expectation that Mr. Berg would perhaps get some options by way of compensation, but that Mr. Berg's basic interest would be as a common shareholder. Mr. Jensen said, "I expected that he would look into his Rolodex to make contacts in the financial community", dealing with rating agencies and "bigger picture" issues. Mr. Larson said, "I expected he would be a one-for-one replacement for Mr. Anderson". Although the Board of Repap was consulted and agreed that the Paloma nominee directors would resign, it did not ask Mr. Berg to become a full-time Chairman or agree to employ him. I find that there was no understanding that Repap would compensate Mr. Berg in any material way or that he would assume a role other than as a non-executive Chairman.

Mr. Berg's Investment in Repap

[37] Much was made of the fact that Repap's financial statements had a "going concern" note, but Mr. Berg was well aware of this. This did not deter him from making a substantial investment in Repap in November 1998 for U.S.$700,000. In January 1999, he increased his investment by purchasing additional shares for U.S.$1,000,000. When he made his investment in November, Mr. Berg could not have expected to have any relationship with Repap except as a common shareholder. Mr. Berg conceded that it was common for him to make speculative investments.

[38] Mr. Berg invested in Repap for the same reason as Third Avenue Funds. The shares were trading at an all-time low of U.S.$0.05. Both he and Mr. Whitman believed there was value in the company that the share price did not reflect. Mr. Whitman's hope was "to hit a home run with a penny stock", which is precisely what happened. On the acquisition by UPM,

Third Avenue almost tripled its investment. Mr. Berg's motivation was no different. His purpose was to make money on the stock. It was only after he was installed as Chairman that he saw the opportunity to make money in another way.

Mr. Berg Becomes Chairman of Repap

[39] Mr. Berg was appointed a director and Chairman of Repap at the Repap Board meeting on January 27, 1999, by a Board consisting of William Anderson, Robert Poile and David McAusland (the Paloma nominees), Guy Dufresne, Robert Bellamy, John Purcell and Steven Larson. There is consistent evidence that there was no discussion at the meeting about Mr. Berg performing a senior executive or management role.

[40] Two important issues in this trial are whether Repap needed a "Senior Executive Officer" in addition to a Chief Executive Officer, and, if it did, whether Mr. Berg was qualified for the job. It is therefore important to examine his credentials against the circumstances of Repap at the time.

[41] In 1999, Mr. Berg was 63 years of age. During the 1970's and 1980's, he had developed a successful business, National Home Products. In 1989 or 1990, the company was involuntarily petitioned into bankruptcy. During the 1990's, he devoted some of his time providing legal services to long-standing clients and some of his time managing the investments of a family holding company. By 1998, he was no longer engaged in an active business life or practising law on any regular basis. He was semi-retired and living in Florida for substantial periods each year. He had last served as a member of a Board of Directors in 1973. However, over the years he had developed a network of business and social contacts and he was not shy about using them. He was experienced in business, but he had no recent or relevant experience to bring to Repap. He was not a restructuring expert or a specialist in the forest products industry.

[42] What expectations would Repap have about the individual I have described? It knew it had not gone out and recruited Mr. Berg. There is no evidence that anyone at Repap believed Repap needed a fourth full-time executive or that he was the candidate to fill that role. Mr. Berg was assuming the role of Chairman as a nominee of Third Avenue. He was replacing Mr. Anderson, a nominee of Paloma, who had served as a non-executive Chairman. The management team had already accomplished the most difficult part of Repap's

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turn-around. According to Mr. MacLellan, there was little or anything that an executive Chairman could contribute. He stated:

> …So you have to start at the beginning and say: What was REPAP'S corporate strategy? And the corporate strategy, as I think I've already explained, was to minimize costs and to wait for an upturn in commodity prices. And except for that there wasn't a lot that could be done. So what that would say, then, is: What structure does that lead you to? And that structure would be that you would have a CEO of a company who was familiar with the operations of a paper making operation, and could get costs as low as possible. A good CFO who could fend off the lenders and the other banks and could extend maturities for as long as possible. And somebody internal to do the legal work.
>
> And in addition to that I think there's room in this kind of a structure for a non-executive Chairman to run the Board meetings, and to address things like the CEO's compensation. Nowhere in this framework that I outlined did I see a need for what was described in this contract as a Senior Executive Officer…

[43] Mr. Berg testified that he outlined at the May 1998 dinner with Mr. Larson (or shortly after) a detailed plan for Repap's restructuring. This plan included converting the second priority bonds to equity and offering the seconds preferred stock with a right to redeem at 100 cents on the dollar over five years. The redemption value of the shares would be the face amount of the bonds, which were then trading in the market below par. He also proposed to give the bondholders warrants, which would become valuable if he could increase the price of the common shares. The bondholders would then get a "free ride on the shares of the stocks".

[44] He planned to change the company's name, re-incorporate in Delaware, relist Repap's shares on the NASDAQ and, in order to meet the minimum trade amount of $5.00, do a reverse stock split. Mr. Berg produced some notes that he made on a napkin at that dinner on which he jotted the names of "Anderson", "Poile", a Repap director, and "Sussman", the principal of Paloma Partners. However, he acknowledged that, apart from these jottings, he was unable to locate any document that he prepared at that time or at any time, that set out this plan, or any plan, for restructuring Repap.

[45] In contrast to Mr. Berg's evidence, five witnesses testified that Mr. Berg had neither a detailed nor a feasible plan. Each of these witnesses described Mr. Berg's "three-point

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restructuring plan", which consisted of a corporate name change, a reverse stock split and a re-listing of Repap's shares on the NASDAQ exchange or the New York Exchange. Some of them recalled Mr. Berg talking in a general way about restructuring the debt. None of them recounted the plan described by Mr. Berg in his testimony.

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[46] Mr. Cohen was asked for his recollection about Mr. Berg's restructuring plans. He did not have a detailed recollection, but on the basis of what he could recall, his evidence is consistent with the testimony of other witnesses. He stated:

> As I recollect, his plans really were strategic and financial. He didn't purport to be a paper manufacturer or know very much about running a mill. But he did have a lot of business experience, and he thought that he could go in and—what the company needed really was a refinancing, they had too much debt. And that it needed a new strategic vision which might lead to some sort of perhaps a sale or a take-over, or something of that sort. But nothing would really happen unless and until the financial structure had been repaired, and he had a lot of ideas in that regard.
>
> Q. Did he tell you what those ideas were?
>
> A. He probably did, but I don't recall specifically other than something had to be done about the debt—either some conversion of the debt into equity, or some refinancing, new loans, and what have you. But, again, specifically, I don't recall.

[47] Mr. Larson noted that a reverse stock split was a commonly suggested strategy that had been discussed and discounted. Mr. MacLellan confirmed that a reverse stock split was not a desirable solution and could actually worsen the situation.

[48] It was Mr. Whitman's evidence that neither he nor Mr. Berg had any clear idea about how to restructure, but he did not think that there was any opportunity to convert debt into equity. Mr. Jensen characterised Berg's "three-point plan" as "cosmetic" and said it did not address the financial problems Repap was facing.

[49] Credit Suisse First Boston had been retained in December 1998 and had concluded that a debt restructuring was not feasible. In April 1999, Jonathan Mishkin of DLJ came to a similar conclusion. This was the opinion of Oasis Capital Group who was also consulted in April about a possible debt restructuring. In rejecting the idea, Oasis explained:

> The bondholders are not geared to voluntarily enter into such arrangements especially when they feel that a company is merely passing through a liquidity squeeze rather than facing a solvency issue.

[50] This statement was an accurate picture of Repap’s financial situation. The company had too much debt and needed to manage it, which Mr. Larson and Ms. Cormier were doing. Michelle Cormier had an excellent relationship with Repap’s bondholders. Along with Mr. Larson, she had successfully raised $320 million of financing in June 1998. Together, they had managed a major restructuring. Before Mr. Berg arrived, discussions were well under way with DLJ and others to refinance Repap’s operating credit facility, which was falling due. Larson and Cormier were a sophisticated, effective, financial management team and were generally credited with keeping the company afloat despite its burdensome debt. That the bondholders had confidence in Repap and in its management was demonstrated in May. DLJ went to the market with a high-yield bond financing on behalf of Repap, which was pre-sold. According to Mr. Mishkin, Mr. Berg’s contribution to the financing was a modest one.

[51] Mr. Berg’s testimony about his restructuring plan stands alone, unsupported by documentation and inconsistent with the evidence of qualified and credible witnesses who were not asked about it. In view of the significance of this evidence, the plan Mr. Berg testified to at trial ought to have been put to them. I accord his evidence little weight for this reason and also because I believe the evidence of the other witnesses to be more reliable than the evidence of Mr. Berg.

[52] It is also of interest that the unexecuted Minutes of the March Board meeting at which Mr. Berg discussed recapitalization with the Board, makes no mention of the plan he described in his testimony. What he reviewed with the Board then was reincorporating in the U.S., with a simultaneous reverse stock split and possible change of name.

[53] For the reasons offered by Mr. Mishkin and Oasis, there was no prospect of any debt restructuring based on the premise that the bondholders would convert their high-interest, secured debt into any form of equity. Nor was there any prospect that the existing shareholders would agree to any further dilution. As Mr. Larson stated, “the restructuring had already taken place”.

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[54] Finally, no restructuring could take place without the involvement of an investment bank. Mr. Berg admitted that his role in any restructuring would be limited to that of “point man,” and in fact, he explored with several investment banks in the spring of 1999, the fees they would charge for their services. There was, therefore, no saving to Repap to have Mr. Berg aboard, as he was not equipped to do this on his own.

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[55] Mr. Berg did not have any particular skills to bring to Repap that weren’t already available to it through its senior management team. His appointment brought no material benefits to Repap that would justify the hiring of a Senior Executive Officer with a lucrative employment contract. How and why did this happen then?

The Genesis of the Agreement

[56] Mr. Berg did not begin to think about an employment contract for himself until early February. When he did, he went to see Mr. Whitman to tell him what he had in mind.

[57] Mr. Whitman had strong views about Mr. Berg’s proposal, which he described as a “huge—huge, huge potential cash bonus based on stock price, options, a sign up option, another option for 75 million. It was quite a package”. Despite this, he said nothing to Mr. Berg. After hearing about it, Mr. Whitman concluded that he and Berg no longer had a community of interest, “Mr. Berg’s interest was not in the common stock—in making money in the common stock. His basic interest was getting rich off an Employment Contract”.

[58] In early February, Mr. Berg retained Proskauer Rose, and specifically, Arnold Rose, as counsel to Repap. Mr. Whitman had known Mr. Jacobs for a long time and was enthusiastic about him. However, it was Mr. Berg’s idea to retain Proskauer. He testified that his primary reasons for doing so were to bring Repap’s security filings up to date (a matter he said he discussed with Mr. Whitman) and to assist in the recapitalization.

[59] Mr. Whitman did not recall discussing the securities filings with Mr. Berg, and I am doubtful that they ever did. The so-called deficiencies in the securities filings were never raised with Terry McBride or with Repap’s securities counsel, Sullivan & Cromwell, or with Stikeman Elliott, Repap’s Canadian counsel. There is no credible evidence that the securities filings were deficient.

[60] When Mr. Berg made the decision to retain Proskauer, he had not yet been to a Board meeting. Apart from Mr. Larson and Mr. Jensen, whom he had recently met, he did not know any of the Repap Directors. He had not been to the head office of Repap. He did not consult the Board, Mr. Larson or Mr. McBride about changing counsel. There was, in fact, no formal retainer of Proskauer until the Board meeting of March 23, 1999. The Proskauer accounts show that in February and March its services were primarily devoted to the preparation of Mr. Berg's contract.

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[61] It is very unlikely that Mr. Berg retained Proskauer for the reasons he gave. He probably did this to assert his control over Repap, to direct the process leading to his contract and to marginalize Repap's senior officers, particularly Mr. McBride. He was the logical person to consult about retaining new counsel, but his views were never sought.

[62] Between February 4, 1999 and February 22, 1999, Ms. Rattner generated two versions of a document entitled "Proposed Term Sheet" and two versions of a document that was first called "Executive Summary of Proposed Employment Agreement for F. Steven Berg" and was later entitled "Employment Contract Term Sheet Between Repap Enterprises Inc. and F. Steven Berg" ("Contract Term Sheet"), collectively referred to as ("Term Sheets"). Each of those four versions of the Term Sheets was sent to Mr. Berg, and at least three contain his hand-written comments. No one from Repap reviewed any of the versions. The preponderance of changes benefited Mr. Berg and not Repap.

[63] Mr. Larson first realized Mr. Berg was seeking compensation when he saw the Contract Term Sheet on February 17, 1999. He was stunned. Both Mr. Larson and Ms. Cormier tried to alert Mr. Berg to the problems that his proposed contract would create for him and for Repap. Mr. Larson's notes reflect the following concerns, which he reviewed with Mr. Berg:

(a) The past Chairman of Repap, Mr. Anderson, took nothing from the company, had no employment contract and did not draw a salary;

(b) The prior Chairman of Repap, Mr. Petty, took everything, destroyed morale, never looked to the team, and put personal greed ahead of results;

(c) The team of Larson, Cormier, McBride, the sales force and manufacturing team had turned the company around in the past two years. Mr. Berg had nothing to do with that turnaround and the toughest part was behind them;

(d) Repap was in a cyclical business, and was a one product company. The coated paper price tended to move the share value. An increase in the price of coated paper would translate into significant earnings in the company, irrespective of the actions of any person;

(e) Repap had extremely limited cash and the company did not need more costs. It was a small Canadian company with a Canadian culture. Repap was not a US company. There were also management and union sensitivities, and such a contract would be detrimental to labour negotiations;

(f)The shareholders of Repap were quiet but significantly diluted and waiting. They did not want to see the Board or management taking action that would dilute them further as would occur with the number of options Mr. Berg required; and

(g) Mr. Petty was watching the company closely, he was still an investor, and he would not react well to Mr. Berg's employment agreement.

[64] Despite their comments, Mr. Berg said it was nonetheless his intention to have a contract with payments and benefits similar to those of the three senior officers.

[65] *Board Meeting of February 22, 1999*

[66] This was Mr. Berg's first Repap Board meeting. It was also the first Board meeting for Pierre Fitzgibbon, Clifford Sifton and Curtis Jensen. They were elected directors at this meeting to fill the vacancies created by the resignations of the three Paloma nominees, as well as that of Mr. Purcell, who decided to leave the Board at that time. Robert Bellamy, Guy Dufresne (the only remaining long-serving directors) and Steven Larson were in attendance, as were Andrea Rattner and Arnold Jacobs. They were there at the invitation of Mr. Berg.

[67] It was at this meeting that Mr. Jensen was elected Chairman of the Compensation Committee. As long-term passive investors, it was not usual for Third Avenue Funds to take a position on a Board, but Mr. Whitman thought that it would be beneficial for Mr. Jensen ("one of my young people"), to gain some Board experience. Mr. Jensen testified that he felt uneasy

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about being appointed as Chair of the Compensation Committee. He had no prior public company Board experience and no experience as a Compensation Committee Chairman.

[68] Mr. Dufresne formed the impression that Ms. Rattner was at the Board Meeting as “an expert” to explain the Berg Agreement. Mr. Jensen testified that he did not know whether Ms. Rattner was there to represent the company or Mr. Berg. In whatever capacity she was there, it is clear the directors did not accept her advice.

[69] The Minutes reflect the Board’s concern with one element of the Agreement, namely the market capitalization bonus. However, this does not accurately reflect the discussion. Rather, as Mr. Jensen said, it reflects the Board’s attempt to find a way to be polite and soften the blow when it had to advise Mr. Berg, after he returned to the meeting, that his contract had not been approved, while the proposed arrangements for management had been. Mr. Jensen’s testimony reveals the difficult and sensitive issues that can arise with the employment contract of a Chairman, particularly if a Chairman is the nominee of the company’s largest shareholder. The Board did not know anything about Mr. Berg or Third Avenue Funds. This is dangerous territory for a Board of Directors and underscores the necessity of establishing an independent Committee to delve into it.

[70] The Board appreciated that it could not bless the Agreement without further scrutiny. At the conclusion of the Board discussion, it was decided some guidance from a compensation consultant was required in order to understand if the Agreement was, to use Mr. Jensen’s words, “within the realm of fairness”. It was Mr. Jensen’s expectation that the Board would retain a firm to review the contract and the consultant would prepare a report to Compensation Committee members. This was also Mr. Dufresne’s expectation. Specifically, Mr. Dufresne asked that the review include a benchmarking analysis as he did not believe that either the manner of the proposed remuneration, specifically, the market capitalization bonus, or the quantum, was common for similarly situated companies. The Compensation Committee was requested to give the Agreement further consideration and report back to the full Board.

[71] There is no credible evidence to support Mr. Berg’s belief that his contract was “approved in principle” at the Board meeting. Nevertheless, even if Mr. Berg genuinely believed this, he soon learned why his contract was not approved.

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The Aftermath of the February 22nd Board Meeting

[72] Mr. Jensen described the Board's reaction to the Berg Agreement as one of "outrage and disgust". On the day following the meeting, Mr. Bellamy, the longest standing member of the Board, unexpectedly resigned. In the week following the meeting, Mr. Jensen was inundated with calls from directors to express their concerns about the Agreement. Mr. Dufresne was one of those who contacted Mr. Jensen.

[73] In a letter to Mr. Jensen dated March 1, 1999, Mr. Dufresne highlighted his concerns, which he expanded on in his evidence. They were threefold.

[74] First, he did not think Repap, which was a one-mill company, could afford or needed two highly paid top executives, that is, an active Chairman and also a President and CEO. He pointed out that the three operating officers of Repap (Larson, Cormier and McBride) were paid slightly above industry average to recognize the difficult conditions they were coping with and their excellent performance.

[75] Second, he did not think Mr. Berg's remuneration should be tied to market appreciation but to the work he would be doing. In his view, the reward of market capitalization was primarily for the shareholders and to a significantly lesser extent, the senior officers.

[76] Third, he wrote that he welcomed Mr. Berg as a full-time Chairman to help resolve the capital structure of the company as he thought this was a better alternative than paying a merchant bank for these services. However, he thought there should be a time limit for his active involvement and suggested three years. This comment shows that Mr. Dufresne recognized there was no benefit to Repap to have a second full-time CEO, unless it resulted in savings to the company. He realized that if Mr. Berg was there to bring about a restructuring, his appointment was a time-limited assignment.

[77] Mr. Berg recognized this too. He testified that he expected to be able to accomplish the restructuring by October 1999, or at least within one year. He did not anticipate being involved with Repap after this. Mr. Berg did not tell the Board this, yet he permitted his contract to go before it with terms that are wholly inconsistent with the terms of employment that a corporation, acting reasonably, would provide to a senior executive who is employed for a short-term, task-oriented assignment.

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[78] Although Mr. Dufresne had sat on several Boards of Directors and continues to do so, this was the only time he had ever written to a co-director expressing concern about an issue then before a Board. He said he took this unusual step because the presentation of Mr. Berg's Contract Term Sheet to the Board was, in his words, "light weight or almost a farce".

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[79] Mr. Dufresne sent his letter to Mr. Jensen as head of the Compensation Committee on a confidential basis. Nonetheless, Mr. Berg acquired a copy of the letter and telephoned Mr. Dufresne. In that conversation, Mr. Berg angrily stated that Mr. Dufresne should have talked to him directly. Mr. Dufresne expressed surprise that Mr. Berg had a copy of his letter and told him that he should not be involved in this exchange because he was the party whose employment agreement was at issue. Mr. Berg's conduct is inconsistent with an independent review of a director-corporation transaction.

The Jensen Memorandum

[80] Following the Board meeting, Mr. Jensen wrote a memorandum on February 26, 1999, for Mr. Whitman. He wished to alert him that there was an immediate problem that needed to be addressed. In his memorandum, he tried to capture some of the concerns expressed to him by the other directors and to illustrate one or two examples of the implications of "the market cap bonus". He testified that he had never seen an executive bonus linking compensation to market capitalization. He also prepared some calculations to illustrate "the rather staggering numbers" that Mr. Berg could earn through this bonus. He indicated that the Board was concerned not only with the absolute numbers, but also with the prospect that Berg could benefit handsomely from an increase in market capitalization, a benefit that could be completely unrelated to his performance.

[81] He recorded that Mr. Berg's proposed compensation package had met with "enormous resistance". He went on to detail the concerns of three directors, Mr. Bellamy (a long-standing Board member who had by then resigned), and Mr. Dufresne (another long-standing Board member) and a newly appointed director, Pierre Fitzgibbon. He pointed out that each of these directors was Canadian and the seven-member Board required at least four Canadians.

[82] He also wrote a section entitled "Potential Solutions". He testified that this was not intended to be an exhaustive list of every possible solution. They included: (1) eliminating the

market cap bonus altogether; (2) reducing the number of shares from 50 million to 15 million and making them options without a loan; and (3) increasing the strike price of the options to the $0.35 to $0.50 range in order to make it a true incentive program.

Jensen's Resignation

[83] After making Mr. Whitman aware of the controversy surrounding the Berg Agreement, they decided that he should immediately resign from the Board. Jensen tendered his resignation on March 1, 1999. His resignation letter, which was sent to Mr. Larson and copied to Mr. Berg, specifically drew attention to the necessity of hiring a compensation expert. His statement leads me to infer that the directors who attended the February Board meeting were not informed that Mercer had already been retained and was in the process of preparing an opinion.

[84] The concluding line of Mr. Jensen's letter states, "Third Avenue Funds is not entitled to, nor does it desire that any warrants or options be issued to it". Previously, it had been contemplated that Third Avenue would receive some options or warrants. Mr. Whitman asked Mr. Jensen to include this to make clear that it was Third Avenue's intention to divorce itself entirely from the Board and to have nothing further to do with Repap, other than as a passive outside investor. According to Mr. Whitman, this meant that Third Avenue would not interfere in decisions of management, approved through an appropriate Board process.

Mr. Berg's Response

[85] By March 2, 1999, Mr. Berg had received a copy of the Jensen memorandum, Mr. Jensen's letter of resignation, Mr. Bellamy's letter of resignation and the letters from two directors, Dufresne and Fitzgibbon, commenting on Mr. Berg's proposed compensation package. He sent this material to Andrea Rattner and asked her to call him.

[86] At the very same time as Mr. Berg received this material, he was in the process of recruiting Stephen Phillips and Marshall Cohen as new Board members. Although Mr. Berg met with Mr. Cohen in Toronto on March 4 and in New York on March 8, and had conversations with Mr. Phillips around this time, he did not show them this material, nor did he ever discuss its substance with them. He took no steps to ensure the existing directors or incoming Board members received it. He took no steps to ensure Mercer received it. He

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informed no one about his conversations with Mr. Larson or Ms. Cormier and their analysis of his contract, in light of the circumstances of Repap at the time.

[87] Following the Board meeting on February 22, 1999 and in the weeks leading up to the March 23, 1999. Board meeting, five versions of the Executive Employment Agreement were prepared by Ms. Rattner and sent to Mr. Berg. Versions one through three contain Mr. Berg's hand-written mark-ups. As with the Term Sheets, no director, apart from Mr. Berg, saw these drafts. During this period, Mr. Berg also saw a draft of the Mercer opinion letter and made some comments on it, although there is no evidence that any director had the same opportunity. By March 8, there was again a functioning Compensation Committee, but Mr. Berg did not bring its three members into the process.

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Berg's March 18, 1999 Memorandum

[88] Mr. Berg, in his capacity as Chairman, sent the directors a memorandum dated March 18, 1999, enclosing a "finalized draft" of his Agreement. It was copied to Ms. Rattner and Mr. Jacobs. As early as March 8, Mr. Berg had prepared drafts of this memorandum and sent them to Ms. Rattner. This belies his assertion that he believed that she was "Repap's lawyer". What possible reason was there for "Repap's lawyer" to review this? Mr. Berg sent the drafts to Ms. Rattner because he wanted her advice on the wording.

[89] Mr. Berg testified that he thought the version of the Agreement he sent to the directors on March 18 was the same version that was executed and he did not appreciate until much later that there was a difference between them. I reject this evidence because Proskauer's dockets show an entry for a March 22 conference between Berg and Rattner and state: "rev. option agmts; rev. emp. Agmt; conf. S. Berg… ". I find that Mr. Berg knew there were changes made to the Agreement.

[90] The changes were by no means insignificant. The version the directors received provided that the grant of stock options was conditional on shareholder approval. This language was removed from the executed Agreement, giving rise to an immediate legal obligation on the part of Repap for the value of the options. This provision is the basis for Mr. Berg's claim in the New York action for U.S.$6,750,000. There were also changes made to the stock option grant, which has an extremely short vesting period. The "finalized draft"

provided that the options would vest on a change of control and if Mr. Berg left Repap. Under the executed Agreement, the options vest immediately on a change of control.

The Compensation Committee

[91] The Compensation Committee was Stephen Phillips, Clifford Sifton and Guy Dufresne. Mr. Dufresne was the only member who had served on the Repap Board for any period of time. Before March 23, 1999, Mr. Sifton had attended one Board meeting in person and had participated in the telephonic Board meeting on March 8, 1999, where Mr. Phillips was elected a director and Chairman of the Compensation Committee.

[92] Mr. Phillips was a former employee of Mr. Berg in the 1980's. He had also held positions in sales and product development in the food and advertising industries and had worked as a business consultant for about ten years, but he had never served as a director of a public company, nor as a director of a Canadian company. He had never chaired a Compensation Committee. The only Repap officer or director he knew was Mr. Berg. He had proposed Mr. Phillips as a director because his residence was in Stamford, Connecticut.

[93] Mr. Berg had also proposed Mr. Sifton as a director and a member of the Compensation Committee, although he did not know him personally. He knew him only as the son of Colonel Michael Sifton, a fellow polo player. As Mr. Sifton did not testify at the trial, I do not know what qualifications he had to serve on the Repap Board, but, based on Mr. Berg's testimony, Mr. Sifton's main qualification was that he was Canadian.

[94] Mr. Phillips' knowledge of Repap was limited and in some cases, wrong. For example, he adopted Mr. Berg's view that Repap was on the verge of bankruptcy and that it was about to disappear unless immediate steps were taken to turn it around. He believed Mr. Berg had been hired to avert a bankruptcy.

[95] His understanding of the Agreement was sadly inadequate. Although he believed it was important for the contract to be performance-driven, in cross-examination, he agreed that many of the key benefits in the contract, such as the signing bonus, the eight years' accrued pension credit and the market capitalization bonus, had nothing to do with Mr. Berg's performance.

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[96] He did not understand how the market capitalization bonus worked. He believed stock prices drove an increase in market capitalization and, if this occurred, it would be due to Mr. Berg's efforts. He did not understand that Repap's stock price could rise due to factors unrelated to Mr. Berg's efforts, such as an increase in paper prices. He did not understand that Repap's market capitalization could increase without a rise in the stock price. He believed that if there was significant improvement in the company's stock price calling for payment to Mr. Berg that, "somehow the company would either find the money, or the Board and Mr. Berg would renegotiate, or if we're on the brink of success, we'll work out the issues".

[97] Mr. Phillips was never told that Curtis Jensen had been the prior Chair of the Compensation Committee. In fact, up until July 2001, Phillips did not know who Jensen was. He did not meet with or discuss the Agreement with Andrea Rattner or Margaret Engel. He did not receive Minutes from earlier Board meetings, a memo from anyone from the Compensation Committee, or any notes from anyone with respect to what might have been discussed about the employment contract. At the same time, he never asked for any material or had any discussions that might have assisted him in fulfilling his duties as Chairman in a responsible manner. Before March 23, the only discussions Mr. Phillips had with any director about the Agreement was a telephone call he said he initiated to Mr. Dufresne on March 22, 1999, about which there is conflicting evidence.

[98] Mr. Phillips testified that Dufresne told him in that telephone call that the Agreement was "a significantly better draft" and he was planning to vote for it. In direct contradiction to this, Mr. Dufresne testified that he objected to the Agreement and did not vote for it. When Phillips' version of the phone call was put to Dufresne in cross-examination, he vigorously resisted the suggestion that he would have made a statement to Mr. Phillips indicating his support for the Agreement.

[99] Although Mr. Dufresne did not recall the March 22 conversation with Mr. Phillips, I believe Mr. Phillips is mistaken in his recollection of this conversation. It was only three weeks earlier that Mr. Dufresne had taken the unusual step of writing to Mr. Jensen about his concerns with the Berg Agreement. It was only four weeks earlier that the Board had requested an independent opinion and had delegated to the Compensation Committee the responsibility of obtaining one and reporting back to the Board. It was Mr. Dufresne who had requested a benchmarking analysis.

[100] Following the February Board meeting, the Contract Term Sheet had been developed into two documents, an Executive Employment Agreement and a Stock Option Grant Agreement. Although some of the provisions had changed, the market capitalization bonus remained, the employment term went well beyond three years and the salary and benefits were at a senior executive level. As none of Mr. Dufresne's objections had been addressed, I find it difficult to accept that he would tell Mr. Phillips he was in favour of the Agreement. Accordingly, I prefer Mr. Dufresne's evidence.

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[101] The Compensation Committee met only once, immediately before the commencement of the March 23, 1999, Board meeting. Mr. Phillips acknowledged that the meeting was not "long" or "involved", nor could it have been as it lasted for a total of five to seven minutes. This "meeting" can hardly be described as a serious attempt on the part of an important Board Committee to review, analyze and discuss with any diligence the matter that was before them. It took Mr. MacLellan one hour on an initial review to work through the provisions in the Agreement. In addition, he sought assistance from two analysts in his department, one with legal experience and the other with a finance background. The Agreement is incapable of being reviewed, let alone understood and discussed, in a five to seven minute meeting.

[102] Apart from its lack of substance, this was not really a meeting of the Compensation Committee at all. As Mr. Dufresne's plane was delayed arriving in New York, he was not present and joined the Board meeting later. Mr. Phillips acknowledged that he had already made up his mind to support the Agreement prior to the Compensation Committee meeting and that he advised Mr. Sifton of this, although neither had seen the Mercer Report. It was distributed during the Board meeting.

The Mercer Opinion

[103] There is no dispute about Ms. Engel's qualifications or her ability to provide a meaningful opinion had she been afforded the opportunity to do this. She is a very experienced executive employment consultant and a principal in Mercer's New York office.

[104] Ms. Engel was retained by Ms. Rattner shortly before the February Board meeting. In her draft opinion, she requested information about Repap, including the company's business plan, strategic direction, compensation philosophy, input from the company's senior management and Board concerning comparator companies or situations to provide a context

for a reasonableness opinion. Had this information been provided to her, she would have learned about the opposition from the Board and management. She would have had some history about Repap. These were matters she said it would have been important for her to know. She could have done a benchmarking analysis. As it was, she believed the Compensation Committee was involved in the negotiations, drafts were going to the Chairman, he was reviewing them and this was having an influence on the process. She did not know the Compensation Committee was not in the loop.

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[105] Ms. Engel testified that Ms. Rattner declined to provide the requested information because of the time frame. She stated:

> …I made it clear because of that—because of that constraint in terms of the time frame, that it would be just impossible to do the sort of, you know, typical back and forth with the company in terms of understanding the underlying business plan and so forth. And that it was certainly impossible to do research on market comparables given that time frame. So I made it clear that our comments would be general in nature based on anecdote or experience or whatever information was readily at hand just because of the time frame.

[106] The public information on Repap that Ms. Engel reviewed was the “minimal bare bones of the corporate structure”. The information did not provide an ability to prospectively judge the company or how the executive might be expected to impact on it. In cross-examination, Ms. Engel agreed that she had provided “high level” opinions in the past, but this does not change the limitations of this kind of opinion. A view from 30,000 feet does not provide a great deal of insight. Mr. Phillips acknowledged that the opinion was not the result of any due diligence, but was essentially a “high level” opinion with a “hedge”. This is a rather startling admission from the Chairman of the Compensation Committee.

The Board Meeting of March 23, 1999

[107] The directors present in person at the meeting were Berg, Cohen, Dufresne, Larson, Phillips and Sifton. This was the first Board meeting for Mr. Cohen and Mr. Phillips. It was the third Board meeting for Mr. Sifton and Mr. Fitzgibbon, but Mr. Fitzgibbon never attended a Board meeting. He participated by telephone each time. Mr. Dufresne was the only outside director who had been a director prior to January 1999.

[108] When the time came to consider the Agreement, Mr. Larson and Mr. Berg left the room at Mr. Phillips' request, and he chaired this portion of the meeting. Ms. Rattner came into the meeting at that point and handed out copies of the Mercer opinion and made a presentation to the Board.

[109] The evidence is unclear which version of the Agreement the directors considered. Mr. Cohen testified that Ms. Rattner reviewed the important clauses of the Agreement. The Minutes indicate that changes from previous drafts were drawn to the attention of the directors. However, Mr. Phillips testified he was not aware the Agreement that was executed was different from the Agreement that had been provided to the directors by Mr. Berg on March 18, 1999. Specifically, he was not aware the language requiring shareholder approval of the options was removed from the executed version of the Agreement. He acknowledged that it would have been preferable for that language to have been in the Agreement. It is evident that Mercer never opined at all on the actual signed Agreement. It did not, therefore, address the changes that had been made to it, and in particular, the implications for Repap's liability of eliminating shareholder approval as a condition of the options.

[110] Mr. Cohen did not recall the Board discussion, but he believed the vote was unanimous, as did Mr. Phillips. Mr. Whitman recalled nothing about the discussion, but testified that the Board "rubber-stamped" the Agreement. Mr. Dufresne testified the vote was "phony", and he did not vote in favour of approving the Agreement. However, he did not dissent. He was fair to acknowledge that he regretted this. In the course of the meeting, he decided that he was going to resign, which he did the following day.

[111] There is consistent evidence that the portion of the meeting devoted to a consideration of the Agreement was brief, probably no longer than one half-hour. There is consistent evidence that no director made any comment on the Mercer opinion. Mr. Dufresne made some comments about the Agreement, although there is conflicting evidence about what he said. Apart from this, there was no comment or discussion about the Agreement. It was, as Mr. Phillips said, a "non-issue".

[112] Against these facts, I turn first to the positions of the parties and next to an analysis of the legal principles that apply in these circumstances.

Part III - Analysis and Law

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The Positions of the Parties

UPM

[113] On behalf of UPM, Mr. Slaght and Ms. Crain submit that because of the manner in which Mr. Berg negotiated and presented for approval the Agreement, he breached his fiduciary duties to Repap. Further, the Repap Directors failed in their own obligations to establish a prudent and reasonable process. Taken together, this led to a contract that is not fair and reasonable or in the best interests of Repap. They submit that this conduct unfairly disregards the interests of TDAM and those of other shareholders. They argue that the appropriate remedy is to set aside the Agreement either under section 241, the oppression remedy provision, or under section 120 of the *Canada Business Corporations Act.* This section permits the court to invalidate material transactions between a director and a corporation where the director has failed to make adequate disclosure and the contract is not fair and reasonable to the corporation when it is approved.

Repap

[114] On behalf of Repap, Mr. Steep and Ms. Teoli submit that Mr. Berg obtained his employment agreement with Repap through breach of his fiduciary duties as Chairman of the Board and a director and also through fraudulent misrepresentations. They rely on at least three false misrepresentations: (1) that Mr. Berg was recruited to effect a restructuring of Repap in a senior executive capacity; (2) that the Mercer opinion was an informed and independent opinion; and, (3) that Mercer's comments and those of the directors had been incorporated into the Agreement. They claim these representations were made with a dishonest state of mind and the directors relied on them to their detriment. The appropriate remedy, they argue, is rescission of the Agreement.

Berg

[115] On behalf of Mr. Berg, Mr. Cherniak and Mr. Glezos submit that this action is an attempt to usurp the jurisdiction of the New York court in which Mr. Berg first commenced his action against Repap. They argue that UPM and Repap seek to have this court substitute its judgment for the business judgment of the directors who were involved with the review and the approval of the Agreement, which was unanimously approved in reasonable reliance on the opinion of Mercer, a leading North American compensation consultant. They further argue

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that UPM has suffered no prejudice because it acquired Repap with knowledge of the Agreement and paid a premium for its shares. It is, therefore, incapable of being oppressed. They submit the Agreement should stand. In the alternative, if certain provisions of the Agreement are found to be oppressive, the appropriate remedy is to rectify the Agreement under section 241 or to vary it under section 120 of the *CBCA.*

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The Duties of Directors

[116] The cases advanced by UPM and Repap are different, but both have as their starting point the common law and statutory fiduciary duties that are imposed on directors of Canadian corporations. These duties require directors to act honestly and in good faith with a view to the best interests of the corporation and to exercise the care, diligence and skill that a reasonably prudent person would exercise in comparable circumstances.

[117] In the context of a director-corporation transaction, there are also duties of disclosure. The *CBCA* codifies the manner and extent to which disclosure must be made. It provides that a director shall disclose to the corporation the nature and extent of any interest he has in a material contract with the corporation. With these principles in mind, I turn first to Mr. Berg.

The Duties of Mr. Berg

[118] In *Gray v. New Augarita Porcupine Mines Ltd.,* a decision of the Judicial Committee of the Privy Council, on appeal from the Ontario Court of Appeal, the court had to consider the level of disclosure that is required to meet the statutory requirement. Lord Radcliffe stated:

> There is no precise formula that will determine the extent of detail that is called for when a director declares his interest or the nature of his interest. Rightly understood, the two things mean the same. The amount of detail required must depend in each case upon the nature of the contract or arrangement proposed and the context in which it arises. It can rarely be enough for a director to say, “I must remind you that I am interested” and to leave it at that… His declaration must make his colleagues “fully informed of the real state of things” (see, *Imperial Mercantile Credit Ass’n v. Coleman* (1873), L.R. 6 H.L. 189 at 201, per Lord Chelmsford). If it is material to their judgment that they should know not merely that he has an interest, but what it is and how far it goes, then he must see to it that they are informed.

[119] Measured against this standard, Mr. Berg's conduct falls well short of what was required of him. The Repap directors were not fully informed of 'the real state of things'. It was material to their judgment to know about the comments of management and prior Board members on his compensation package. It was material to their judgment to know that Mercer had not done any research, benchmarking or analysis of comparable companies as requested by the Board at the February 22, 1999, meeting. It was material to their judgment to know that the Agreement tabled before it on March 23, 1999, was different in several important respects from the version they received with the March 18, 1999, memorandum. It is no answer to the duty to disclose to say the directors could have discovered this for themselves. The duty to disclose is an absolute one, because, without full disclosure, any investigation into whether the beneficiary would have acted in the same manner is impossible.[2]

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[120] Disclosure of a director's interest is but the first step. Disclosure does not relieve the director of his duty to act honestly and in good faith with a view to the best interests of the corporation. The director must always place the interests of the corporation ahead of his own.[3] *Pente Investment Management Ltd. v. Schneider Corp.*[4] and *CW Shareholdings Inc. v. WIC Western International Communications Ltd.*[5] are take-over bid cases. They are helpful decisions because they raise conflict of interest issues that are not unlike those that can arise in a director-corporation transaction. The classic way that Boards protect themselves when conflicts arise is to retain independent legal and financial advisors and to establish independent or special directors' committees.[6]

[121] There was little that was independent about the process Mr. Berg followed. He retained Proskauer without consulting the Board and set them to work on his contract. The employment contracts of the three senior officers were also being revised at this time. It was appropriate for Mr. Berg to exercise an oversight role in this process. It was inappropriate for him to exercise an oversight role in regard to his own contract.

[122] Mr. Berg testified that he put no restrictions on Ms. Rattner and gave her no instructions to preclude her from dealing with Repap's Compensation Committee or the Board

[2] K.P. McGuiness, *The Law and Practice of Canadian Business Corporations* (Toronto and Vancouver, Butterworths, 1999) at para. 8.235, p.754; see, *Crighton v. Roman*, [1960] S.C.R. 858 (S.C.C.), per Cartwright J. at p. 869.
[3] *Levy-Russell Ltd. v. Tecmotiv Inc.* (1994), 54 C.P.R. (3d) 161 (Ont. Gen. Div.) at 341 [123-124 QL])
[4] (1998), 42 O.R. (3d) 177 (Ont. C.A.) ("*Maple Leaf Foods*").
[5] (1998), 39 O.R. (3d) 755 (Ont. Gen. Div. [Commercial List]) ("*CW Shareholdings*")
[6] Ibid at 10.

of Directors. He says he left this to Ms. Rattner. This is not an answer to his fiduciary duties. Mr. Berg, not Ms. Rattner, was Chairman and a director of Repap. He knew or ought to have known that she was preparing drafts of his contract for his review and comment, but that the Compensation Committee was not involved. It was a breach of his fiduciary duty to instruct Ms. Rattner on the terms of his contract, as I find he was, without ensuring that Repap's interests were also protected.

[123] The *CBCA* does not expressly provide that a director must make sure the corporation is independently represented in negotiating the terms of a transaction. However, a director is most ill-advised if he does not make every reasonable effort to ensure that the corporation receives independent representation beginning with the negotiation stage of the contract process.[7] There can be little question that there was no negotiation of this contract. Repap was not involved at all.

[124] To make matters worse, Mr. Berg did not conduct himself in an upright manner, as he was required to do. He requested types and amounts of compensation that he knew or ought to have known were not in the best interests of Repap, a company, which he believed was "on the brink of bankruptcy". He removed from drafts of the Agreement reasonable safeguards for Repap, including good faith renegotiation of windfall bonuses, performance criteria and shareholder approvals. If there is any validity in his evidence that the entire restructuring was to be complete within the year, he had a duty to disclose this and to ensure the terms of his contract limited Repap's liabilities in that event. Mr. Berg's conduct fell short of the standard of integrity required of a fiduciary in its dealing with the corporation.

[125] A reasonably prudent Chairman and director acting in the best interests of Repap would have provided a mostly new Board with the opportunity to educate itself about the company so as to have a basis to ground an informed business judgment about the Agreement. A reasonably prudent Chairman and director acting in the best interests of Repap would have afforded the Board adequate time to retain a compensation consultant, to instruct the consultant and to consider a genuinely independent opinion about his own employment contract. A reasonably prudent Chairman and director acting in the best interests of Repap would have arranged for someone at Repap to instruct Ms. Rattner with respect to the negotiation of the Agreement. A reasonably prudent Chairman and director acting in the best

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[7] *McGuiness, supra*, note 5 at para. 8.248, 760.

interests of Repap would have done none of the things Mr. Berg did and would have done all of the things he failed to do.

[126] Mr. Berg failed utterly in his duties to Repap. His own self-interest prevailed. His conduct was exactly opposite to the conduct that the law required of him as a fiduciary - disclosure, honesty, loyalty, candour, and the duty to favour Repap's interest over his own. This failure is illustrated starkly by his conduct after the Agreement was approved and came under attack by Repap's shareholders. I will come to this shortly.

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The Duties of the Board of Directors

[127] There is no serious complaint that the directors who approved Mr. Berg's agreement failed to act honestly or in good faith. The focus of the attack on their conduct is their failure to act carefully, diligently and skilfully in the best interests of the corporation.

[128] It is settled law that the duty of due care requires that where directors make decisions likely to affect shareholder welfare, their decision must be made on an informed and reasoned basis. In *CW Shareholdings,* Mr. Justice Blair expressed it in this way:

> In the end, they must make a decision and exercise their judgment in an informed and independent fashion, after a reasonable analysis of the situation and acting on a rational basis with reasonable grounds for believing that their actions will promote and maximize shareholder value: see, *820099 Ontario Inc. v. Harold E. Ballard Ltd.* (1991), 3 B.L.R. (2d) 123 (Ont. Gen. Div.) at p. 176; *Olympia & York Enterprises Ltd. v. Hiram Walker Resources Ltd.* (1986), 59 O.R. (2d) 254 at pp. 270-273, 37 D.L.R. (4th) 193 (Div. Ct.).[8]

[129] A Board is entitled, indeed encouraged, to retain advisors, but this does not relieve directors of the obligation to exercise reasonable diligence. In *Hanson Trust PLC v. ML SCM Acquisition Inc.*[9], the United States Court of Appeals for the Second Circuit was asked to determine if directors' approval to grant a lockup option of substantial corporate assets in a take-over struggle was protected by the business judgment rule. As Pierce J. stated, in duty of care analysis, a presumption of propriety inures to the benefit of directors, who enjoy wide latitude under the business judgment rule in devising strategies. However, as he noted:

[8] *CW Shareholdings, supra* note 8 at 10.
[9] *Hanson Trust PLC v. ML SCM Acquisition Inc.,* 781 F.2d 264 (U.S. 2nd Cir. N.Y. (1986) at 274 -276 [14-16 (Lexis)].

> The proper exercise of due care by a director in informing himself of material information and in overseeing the outside advice on which he might appropriately rely is, of necessity, a pre-condition to performing his ultimate duty of acting in good faith to protect the best interests of the corporation.[10]

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[130] Here, the Compensation Committee exercised no oversight role whatsoever, although it was the independent duty of that group of directors to have such involvement. It provided no instructions to Ms. Rattner or Ms. Engel. It consulted no legal or expert advice. It took no steps to inform itself of the prior deliberations or comments of the previous members of the Compensation Committee or Board. It took no steps to obtain the Mercer Report before formulating a recommendation. In short, the Committee did not have or seek sufficient information upon which to ground a reasonable judgment about whether to recommend the Agreement, yet other directors relied upon the assumption that a full review had been done.

[131] No director could have considered the Mercer Report in any meaningful way as no director had seen the report before the Board meeting and there was no opportunity to study it carefully during the meeting. Mr. Fitzgibbon, who participated in the Board meeting by telephone, had never seen the Mercer letter. Nonetheless, he voted in favour of the Agreement. There were enough qualifiers, inconsistencies and question marks in the Mercer opinion that any Board acting prudently should have slowed the approval process and delved into the compensation package.

[132] In *Hanson,* Pierce J. held that a *prima facie* case was made out that the directors breached their fiduciary duties in making their decision after a three-hour, late-night meeting relying on their financial advisor’s “conclusory opinion” and without asking enough questions of their advisors prior to making a decision. The Board failed to read or review carefully the various offers and agreements and instead relied on the advisors’ descriptions.

[133] The circumstances were no different here. The Board assumed or permitted itself to believe that the Agreement was performance-driven when many aspects of it were not. Mr. Phillips admitted as much on cross-examination. Mr. Cohen acknowledged that paper prices would have an impact on the share price and increase the market capitalization, but he said that as it was very difficult to isolate the CEO’s productivity contribution from exogenous factors, it was not common to try to do this. This approach may be defensible in the common

[10] Ibid. at 16.

case, but this was an uncommon case. Mr. Cohen had never seen a bonus tied to market capitalization. Neither had anyone else.

[134] Ms. Engel described the bonus as “unique”. As a result, she could find no direct comparables. The directors who reviewed the Contract Term Sheet in February did not have the benefit of Ms. Engel’s comments but they understood that the bonus was not performance-driven. They also appreciated the exposure it created for Repap. On Mr. Jensen’s calculations, if the share price increased to $0.15, Repap was liable to pay a bonus to Mr. Berg of $7.2 million; if the share price increased to $0.25, the bonus was $13.9 million.

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[135] The Jensen memorandum noted that the last time the industry announced a paper price increase; Repap’s stock went from $0.10 to $0.38, although this increase was unrelated to any efforts by management. In direct contradiction to this, Mr. Berg testified that an increase in paper prices would not be reflected in an increase in share prices. There is no support for his view.

[136] Mr. Cohen testified that in cyclical commodity-based industries, exogenous prices have a bigger impact on share price performance. Mr. MacLellan was asked what he would conclude about the knowledge of somebody who thought there was no relationship between paper prices and share price. He said:

> I would find it inconceivable that anybody could think that. The—the number one determinant for REPAP’S share prices is going to be the commodity at which they sell their product. So REPAP would be no different than any other commodity producer, which is absolutely dependent on the commodity price of the product they’re selling. So, for example. Inco is absolutely dependent on the price of nickel. And Alcan is absolutely dependent on the price of aluminium. And anyone in the gas company that you want to mention would be dependent on the price of oil and gas. And as those commodities go up and down the earnings of the company are all affected the same way as the commodity price. And the share prices all move in that same direction…

[137] The point here is that the directors did not engage in any kind of analysis. Had they done so, they should have come to the conclusion that a bonus tied to the market capitalization of a company such as Repap was wholly inappropriate. It was the price of paper

and not the performance of Mr. Berg that would have an impact, if not the biggest impact, on the share price. Mr. Berg's evidence on this point is not credible, but if he genuinely believed paper prices and share price were unrelated, this reflects a complete lack of understanding of the factors that influenced Repap's stock price.

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[138] The Agreement that went before the directors in March did not contemplate the payment of a bonus upon a debt to equity conversion. This provision had been in the Contract Term Sheet. Its removal was a basis for Mr. Berg's contention that the concerns of the directors had been addressed. However, an equity issue, merger, or rights offering, could equally cause the share price to stay flat and the market cap to go up, resulting in a cash bonus to Mr. Berg without any corresponding benefit to shareholders.

[139] The whole concept of the market capitalization bonus was flawed. It exposed Repap to cash payments of potentially millions of dollars, notwithstanding that an increase in market capitalization would not necessarily result in an increase in cash to pay the bonus. There was no correlation to either share price or performance. Although earlier drafts of the Agreement had limiting language to achieve this, this language had been deleted.

[140] Repap was a cash-constrained company. It was unreasonable for the Compensation Committee to recommend an Agreement with this provision knowing that Repap might not be able to afford it, and relying, as Mr. Phillips testified, on the assumption that Mr. Berg would be willing to renegotiate with Repap. The directors who approved the Agreement in March could not have understood the implications of this bonus for Repap. The Mercer opinion very clearly states that it exposed Repap to "significant compensation expense". In view of this, it was unreasonable for the directors to approve an Agreement with this provision when they knew that Repap might not have the cash to pay the bonus.

[141] The comparators that are used throughout the Mercer opinion are to U.S. practice. Mr. Cohen testified that he thought that this was appropriate, as Repap was, in most ways, an American company. This was not Mr. Larson's view. Mr. Larson is American, but he took pains to point out to Mr. Berg in February that Repap was a Canadian company with a "Canadian culture". Ms. Engel could have provided a benchmarking analysis. She could have compared the Agreement with other paper companies or with other Canadian companies. She compared it only to other highly leveraged companies in the United States. This should have raised a duty of inquiry.

[142] Ms. Engel was not invited to the Board meeting to address her opinion, which she said was unusual. She should have been there. Mr. Berg, the Compensation Committee and the Board failed in their duties to ensure her presence in these circumstances.

[143] Mercer described the amount of dilution created by the equity and stock option grants as “at the high end of practice”, meaning American practice. Mr. MacLellan had never heard of a stock option grant of this magnitude under Canadian practice. As he said:

> …the thought that an individual could be awarded immediately 10% of the company under option was something that was so large that I had never seen it before. It’s very rare that you see companies giving the whole management team 10% over a long period of time. It is unheard of in my experience to give one individual 10% under option.

[144] Under the policies of the Toronto Stock Exchange (“TSE”) and Montreal Exchange (“ME”), the maximum number of options normally permitted to one individual was up to 5% of the total capitalization of the company. Other aspects of the stock option grant, for example, the pricing of the options, provoked a large number of comments and concerns from staff at both exchanges. Mr. Raymond, Canadian securities counsel to Repap at Stikeman Elliot in Montreal, testified that this degree of comment was highly unusual because the TSE and ME did not normally receive a request for approval of a stock option grant of this magnitude and with these features.

[145] Whether or not Repap was in substance an American company in 1999, it was nonetheless, a company incorporated under the *CBCA* with its shares trading on Canadian exchanges. The approvals of the TSE and ME are required so these regulators may be satisfied that the issuance of the options does not create dilution for the shareholders of a publicly traded company. The stock option grant of 75 million shares and the signing bonus of 25 million shares together amounted to an award of 13.4% of Repap. By any standard, this was excessive shareholder dilution.

[146] Although the Board knew next to nothing about Mr. Berg, it approved a contract that is drafted in such a way that it would virtually be impossible for Repap to terminate him for cause. On termination without cause, there are a host of payments that are due. According to Mr. Berg, the value of the termination provisions is $27 million, which is the amount that he is

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claiming in the New York action. The directors never turned their mind to the kind of exposure this could create for Repap.

[147] The Board never questioned why there was a change of control provision in the Agreement. It is drafted in the widest possible language and includes any sale or reduction in share ownership to less than 10% of the stock. It is effectively a single trigger provision as the only requirements are that there be a change of control, and that Mr. Berg leave, involuntarily or voluntarily, within a specified time frame. Upon that event, he was entitled to a number of extraordinarily generous payments, including the remainder of his salary (U.S.$420,000 as of January 27, 1999) for the full employment term (5 years plus two automatic renewals of 2 years each), an additional eleven years past service credit (a pension of approximately U.S. $190,000 annually) and full vesting of the stock options, tied only to a change of control.

[148] The Board had a duty to understand why Mr. Berg was at Repap. Mr. Berg knew why he was there. As he testified, he was there “to fix it up and sell it”. What possible commercial purpose did a change of control provision serve in such circumstances? Under the language of the change of control provision, a restructuring would in all likelihood result in a change of control, as would a sale. A change of control provision is a form of protection for a senior executive. It is not a form of payment for performing the job you were hired to do. That Mr. Berg was protected by this provision at all is illogical. That 75 million stock options would immediately vest and trigger other extremely generous payments was never questioned by the Board and should have been.

[149] There was no urgency and yet the entire process was the subject of haste and a rush to approval. In *Hanson,* the court rejected SCM’s defence that it was a “working board” that was familiar with the corporation and therefore capable of making the swift decisions it did. This was not a “working board”. As a mostly new Board, the directors owed the shareholders a higher duty to go slowly and to educate itself thoroughly. Mr. Dufresne was the only serving director who tried to address the unfavourable implications of the Agreement for Repap. Still, Mr. Dufresne did not do enough. He did not press his concerns forcefully enough. He did not formally dissent or otherwise act to protect the shareholders’ interests. This was his obligation even if he chose to resign.

[150] The position of “Senior Executive Officer” gave Mr. Berg general oversight responsibilities for all aspects of Repap except day-to-day manufacturing operations.

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Although the Board did not know this, it is clear from the mark-ups to the drafts of the Agreement in Mr. Berg's hand that he developed the title and the job description, which progressively increased his area of responsibility and diminished Mr. Larson's duties. On its face, the position responsibilities of the SEO overlap those of the CEO and, to some extent, the CFO.

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[151] The Board never asked why Repap required a full-time "SEO" when it already had a CEO and CFO who were performing well. Neither the Compensation Committee nor the Board sought management's views about the Agreement. Instead, the Board directed Mr. Larson to absent himself from the deliberations, when they ought to have required his presence in order to ensure that these views were thoroughly aired and considered.

[152] The SEC title first appeared in a version of the Agreement around the middle of March. When Mr. Larson saw this, he called Mr. Berg who told him this had been inserted at the request of "his advisors", but Larson should not be concerned because, "it's just part of the game; don't worry about it, you're still in charge".

[153] These were difficult circumstances for Mr. Larson with a new Chairman making excessive compensation demands and new lawyers and directors selected by the Chairman. Even so, if he knew the Chairman regarded his position title and responsibilities as a fabrication to justify his contract, he had an obligation to say something. He spoke to Mr. Dufresne before the March 23rd Board meeting, but only about the overlap with his duties. Apart from Mr. Berg, Mr. Larson had the most knowledge about the process and the terms of the Agreement. As a Repap director, it was Mr. Larson's obligation to bring this information to the attention of the Board, consistent with his duty to place the interests of Repap ahead of his own.

[154] Finally, Mr. Whitman was present for the Board meeting on March 23, 1999, but said nothing. Despite his views, he did not communicate either his approval or disapproval of the Agreement. This posture may be an unusual one for a company's largest shareholder, but the directors were not entitled to take his silence as acquiescence. Whatever views Mr. Whitman had or was assumed to have, the Board owed duties to all the shareholders of Repap. A Board does not act in the interests of the largest shareholder. In exercising its duty of care to

the corporation, a Board must consider the shareholders generally not only the shareholder with the largest single vote.[11]

The Business Judgment Rule

[155] The business judgment rule protects Boards and directors from those that might second-guess their decisions. The court looks to see that the directors made a reasonable decision, not a perfect decision.[12] This approach recognizes the autonomy and integrity of a corporation and the expertise of its directors. They are in the advantageous position of investigating and considering first hand the circumstances that come before it and are in a far better position than a court to understand the affairs of the corporation and to guide its operation.

[156] However, directors are only protected to the extent that their actions actually evidence their business judgment. The principle of deference presupposes that directors are scrupulous in their deliberations and demonstrate diligence in arriving at decisions. Courts are entitled to consider the content of their decision and the extent of the information on which it was based and to measure this against the facts as they existed at the time the impugned decision was made.[13] Although Board decisions are not subject to microscopic examination with the perfect vision of hindsight, they are subject to examination.

[157] In March 1999, Repap did not require, nor could it afford, Mr. Berg's services. With a minimum of effort, the Compensation Committee and the Board could have learned this and everything else they needed to know to make an informed decision on a reasonable basis. This did not occur. Instead, the Agreement was approved on the recommendation of a Compensation Committee that never met to discuss it and had no substantive involvement in the process that led to it.

[158] The business judgment rule cannot apply where the Board of Directors acts on the advice of a director's committee that makes an uninformed recommendation.[14] Although it was not unreasonable for the Board to assume the Committee had done a careful job, this did not relieve the directors of their independent obligation to make an informed decision on a reasonable basis. In order to act in the best interests of the shareholders of Repap, each

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[11] *820099 Ontario Inc. v. Harold E. Ballard Ltd., supra*, note 10 at 177 [(1991), 3 B.L.R. (2d) 123 (Ont. Gen. Div.)].
[12] *Maple Leaf Foods, supra*, note 7 at 10.
[13] *CW Shareholdings, supra*, note 8 at 10.

director was required to understand the terms and meaning of the Agreement and to consider it carefully against the circumstances of Repap at the time. They were required to review the Mercer opinion carefully and evaluate it thoughtfully against the circumstances of Repap at the time. This did not happen.

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[159] A contract, such as the one in issue between the Chairman and the Company, should be the subject of careful, objective analysis, and it was not. The process leading up to the March 23, 1999, meeting and the proceedings there fall far short of the exercise of prudent judgment in the interests of the shareholders that is expected of directors. In the space of thirty minutes taken up with Ms. Rattner's presentation, without questions or discussion, with comment from the only director who had served for longer than two months, the Board of Directors of Repap approved an Agreement that gave someone it did not know, had not recruited, and had just met, a generous salary with a lengthy term of employment, an unprecedented bonus structure, termination and change of control protection inconsistent with the employment objective, and stock options amounting to 13.4% of the company. The directors did not fulfil their duties to Repap. Their decision was not an informed or reasoned one. The business judgment rule cannot be applied in these circumstances to protect their decision from judicial intervention.

Events Subsequent to March 23, 1999

Shareholder Opposition

[160] The Agreement first came to the attention of Robert Poile of CAP Advisors Inc. when it was annexed to Repap's "Form 10K" S.E.C. filing. CAP was a shareholder of Repap and Mr. Poile was a former director. Byers Casgrain, counsel to CAP, sent a letter dated April 14, 1999, to several stock exchanges, which was copied to the Repap Board. The letter states in part:

> At the request of our client, we have reviewed the Employment Agreement and the Option Agreement. This review was made in view of our client's substantial concern about the legitimacy and fairness of the Employment Agreement and the Option Agreement and possible related issues of conflict of interest. Our client is of the view that the Employment Agreement and the Option Agreement are oppressive to the

[14] *CW Shareholdings, supra*, note 8 at 13-14.

> shareholders of the Corporation, contain abusively generous terms for the Executive, may have been negotiated on a non-arm’s length basis.

[161] The letter goes on to review other concerns including a possible lack of independent assessment of the Agreement by a separate and independent committee of the Board and share compensation arrangements in contravention of the rules of the TSE and the ME. Despite the clear language of the letter, which is highly critical of the Agreement and the process by which it was approved, Mr. Berg refused to admit the letter was a fundamental attack on the whole Agreement and this refusal reflects generally and adversely on his credibility.

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[162] In May and June, Mr. Berg had several discussions with Mr. MacLellan and Mr. Larson about the Agreement against the background of increasing shareholder opposition to it. In these conversations, Berg made remarks that were intended to threaten and intimidate. For example, he told Mr. MacLellan that if the 75 million options were not approved by the TSE, he intended to take cash from Repap to offset the amount that would represent his loss. He emphasized that Repap was a cash-constrained company and that if MacLellan were to defeat the Agreement, he intended to present Repap with an immediately payable cash amount. He outlined the dire consequences that could flow from a change in control of the Board. None of this evidence was contradicted or explained.

[163] Mr. Larson urged Mr. Berg to unilaterally change his Agreement so the option grant would comply with TSE requirements. In response, Mr. Berg said, “My contract is a play - just to negotiate a settlement when (the) company is sold (or) merged - (and) then get the cash, (U.S. $10 million)”. He made similar comments to Mr. MacLellan. These statements echo ones made to Mr. Lawson in March in connection with the SEO title and to Ms. Cormier in February. When she asked him whether Repap would have to purchase immediately the automobile that his contract provided, he replied, “No, but I want to set it up in the contract as a liability”.

The “Berg Pur”

[164] There had been on-going discussions between Ms. Cormier and Jonathan Mishkin of DLJ since the end of 1998 about a refinancing of Repap’s debt. This came together in April in the form of a proposal for a high-yield bond financing to which I have already made reference.

An engagement letter was signed on May 17, 1999, but DLJ had been working on this for some weeks when Mr. Berg called Mr. Mishkin to tell him that he wanted to put a change of control clause in Repap New Brunswick's offering memorandum. This request was referred to at trial as the "Berg Put". The idea Mr. Berg proposed was the same concept as that set out in a hand-written note, which Mr. Berg admitted he sent to Mr. Jacobs of Proskauer on May 14, 1999. The note says:

> If the present Chairman and SEO leaves for any reason except by his own consent, illness, disability or death on 60 days notice this (sic) Bonds are callable if present (sic).

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[165] In uncontradicted evidence, Mr. Mishkin testified that Berg said to him:

> Look, all I want to make certain is someone comes to buy the company or force me out they got to come through me, they got to pay me off, they got to make me whole, do something for me or else it will collapse the capital structure.

[166] According to Mr. Mishkin and Mr. Raymond, "the put" made no sense from Repap's perspective. Repap had a very precarious capital structure, and this language would have interfered with the balance the bankers were trying to achieve. None of the bondholders had ever asked for this and, frankly, it is difficult to imagine why they would. Mr. Mishkin had never seen it done before in the high-yield market. Moreover, the company issuing the bonds was Repap New Brunswick Inc. Mr. Berg was not an officer of this company, although he soon attempted to see to it that he was. A proposed Board of Directors resolution of May 25, 1999, emerged just prior to the closing of the DLJ bond financing. Mr. Berg claimed it "came from the lawyers" but the evidence does not support this. Contrary to the terms of his own contract, the resolution gave Mr. Berg sole responsibility to manage and supervise the business affairs of Repap New Brunswick. It put Mr. Berg exclusively in control of Repap's most valuable asset.

[167] Ultimately, the proposed resolution was revised and the "Berg Put" was not included in the final offering memorandum, because the Canadian tax lawyers were unable give a supportive tax opinion. When Mr. Mishkin called Mr. Berg to tell him this, Mr. Berg was angry. This evidence is consistent with testimony from Ms. Cormier, who reported Mr. Berg saying, "I know what Stikeman Elliott is up to and this is not going to be the end of it".

[168] There was no valid commercial purpose for either the Board resolution or the “Berg Put”. Both were detrimental to Repap’s interests. Mr. Berg’s motive was entirely improper. Knowing that the Agreement was under attack and required shareholder approval at the annual meeting then scheduled for June 18, these were plans to protect and entrench himself at the expense of Repap.

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The Lawsuits

[169] As opposition to the Agreement mounted, Mr. Berg completely lost sight of the obligations imposed on him by law, and, in particular, his duty to favour Repap’s interest over his own. This is perhaps best revealed in a “speech” made by Mr. Berg to Mr. Larson and Ms. Cormier on May 28, 1999, following the closing of the DLJ bond financing. Mr. Larson made the following notes of Mr. Berg’s soliloquy. The statements attributed to him were not disputed or explained in Mr. Berg’s testimony:

> I have huge resources at my disposal ($100 million financing) and now I have the company till as well. I’m in the catbird seat and can’t lose. I’m also going to get a letter from DLJ to attach to the suit that opines the bonds will go down with my removal (change of control, rating downgrade, default the company, that’s the $1 billion). He (Mr. Poile) better understand. That any attempt to remove me or this Board will result in my taking intentional steps to destabilise the bonds and default the company. I wrote the book on proxy fights don’t corner me. Even if I lose I win. I’ll immediately file a US $25 million suit against the company for my contract the next day. This will also destabilise the bonds. I’m also filing a personal suit against Poile for tortuous interference with my legal employment contract. I’m in the catbird seat. You do what you want Larson but if not with me, you’re putting your position at risk. If you oppose me in this, I’ll come at you and your personal assets with the company and its resources aligned with me.

[170] While Mr. Berg was Chairman, Repap sued Mr. Poile and Mr. McBride, much as he had threatened. Mr. Berg also terminated Mr. McBride’s employment. Subsequently, Mr. Berg took legal action against Mr. Larson and the Toronto-Dominion Bank. In this lawsuit, he alleged that the take-over of Repap by the new Board was engineered by Mr. Cohen who “…masterminded the resignation of Repap’s independent directors so that TD Bank could appoint five new directors under his control”. This allegation is completely false and without any foundation.

Part IV - Remedies

[171] The remedies that are requested by UPM and Repap arrive at the same result—the setting aside of the Agreement. I will begin with the fraud case advanced by Repap and then will consider the remedies sought by UPM under section 120 and 241 of the *CBCA.*

Fraudulent Misrepresentation

[172] The appropriate test for civil fraud is the test that was stated by Lord Hershell in *Derry v. Peek* in the following passage:[15]

> [f]raud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent, there must, I think, always be an honest belief in its truth. And this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief. Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.

[173] To succeed in an action for fraudulent misrepresentation, the plaintiff must show that the defendant not only spoke falsely and contrary to belief, but that the defendant had the intent to deceive, which is to say he had the aim of inducing the plaintiff to act mistakenly and the plaintiff did so to its detriment.

[174] Repap alleges that Mr. Berg actively misled the Board into believing, among other things, he was recruited to effect a restructuring of Repap, that Third Avenue wished to have him employed as Chairman and SEO to do this, that the Mercer opinion was informed and independent, and that the Agreement that the directors received as the “finalized draft” incorporated the comments of Mercer and of the directors when he knew that none of this was true.

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[15] (1889), 14 A.C. 337 (U.K. H.L.) at 374.

[175] Fraud involves a discordance between what a person says and what a person believes:[16]

> The question is not whether the defendant in any given case honestly believed the representation to be true in the sense assigned to it by the court on an objective consideration of its truth or falsity, but whether he honestly believed the representation to be true in the sense in which he understood it albeit erroneously when it was made.[17]

[176] As it is the defendant's belief and intent that are in issue, the false statements must be understood with the meaning placed on them by Mr. Berg.

[177] I do not agree Mr. Berg actively misled the Board about his role at Repap. Mr. Berg had brought the deal to Mr. Whitman. It was understood that Mr. Berg would become Chairman and they would work together on some kind of restructuring. From early February, Mr. Whitman knew Mr. Berg was planning to do this as an executive Chairman, on a full-time basis. He did not oppose it. It was not unreasonable for Mr. Berg to believe he had been "brought in" by Third Avenue to do this and Mr. Whitman supported this plan. There was nothing that Mr. Berg said or did or failed to say or do, that amounts to a fraudulent misrepresentation on this score.

[178] Mr. Berg provided the Jensen memorandum and the directors' letters to Ms. Rattner. There is no evidence that he instructed her to conceal this material, and I will not draw an inference that there was a nefarious reason that she did not bring this to the attention of the directors. Fraud must be strictly proved. Mr. Berg was not entitled to assume Ms. Rattner would look after its distribution, but his conduct was not fraudulent. If he wanted to intentionally deceive the Board, he would not have sent anything to Ms. Rattner. Moreover, he knew Mr. Whitman and Mr. Larson had the material, and he did not have any control over their use of it.

[179] Repap's case relies heavily on the contents of Mr. Berg's March 18th memorandum, which it characterizes as a "landmark in the evidence" against which to measure his misrepresentations and omissions. Its salient portion reads:

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[16] Paul M. Perell, "*The Fraud Elements of Deceit and Fraudulent Misrepresentation*", [1996] 18 Advocates' Q 23 at 24.
[17] *Akerhielm v. de Mare*, [1959] A.C. 789 (Kenya P.C.) at 805, per Lord Jenkins.

> Enclosed you will find a finalized draft of my employment agreement with Repap Enterprises, Inc. This draft incorporates a number of comments and suggestions previously made by the Directors, as well as the consultants and others. It has been further reviewed by William M. Mercer, Inc., the independent compensation consultants retained by the company whose comments are also incorporated therein. I had hoped to enclose Mercer's letter to the Board concerning their review with respect to the reasonableness of the proposed contract, a copy of which I am advised you will receive if not before, then at the meeting on the 23rd.

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[180] After the February Board meeting, there were some changes made to the Agreement. Specifically, the Contract Term Sheet provided for a loan for the stock options, which was removed, as was the payment of a market capitalization bonus upon a debt to equity conversion. Mr. Berg testified that these changes addressed the directors' concerns. On any fair reading of the Jensen memorandum, the executed Agreement did not address all of the objections and Mr. Berg's refusal to acknowledge this also reflects adversely on his credibility. However, the memorandum does not misrepresent this. It says the Agreement incorporates "a number of comments and suggestions" and it did.

[181] Was it fraudulent then for him to describe Mercer as "the independent compensation consultants retained by the company whose comments are also incorporated herein"? The reference to Mercer is more troubling as Mr. Berg alone had seen a draft of the opinion and had made some factual comments on it. Mr. Cohen testified that there was nothing unusual about an executive reviewing a draft of an opinion concerning the executive's own compensation. I must say I find this surprising. Nevertheless, there is no evidence that Mr. Berg spoke with Ms. Engel or influenced the content of her opinion in any way. Nor is there evidence that he was involved in her retainer, which Ms. Rattner arranged.

[182] The percentage payments on which the market capitalization bonus is based were amended as a result of Ms. Engel's comments. Therefore, to this extent, it was not inaccurate to say that Mercer's comments were incorporated. Viewed objectively, the memorandum is somewhat inaccurate and somewhat misleading, but I cannot say the meaning placed on it by Mr. Berg is so far removed from the sense in which it would be understood by a reasonable

person as to make it impossible to hold that he honestly understood it to bear the meaning claimed by him.[18]

[183] There is no evidence that Mr. Berg's description of Mercer deceived any Repap director. Mr. Phillips knew that the Mercer opinion was being prepared at the request of Ms. Rattner as he had spoken with her to find out when it would be available. He could have contacted Ms. Engel. In the memorandum, Mr. Berg invited the directors to contact Mr. Phillips or himself with any questions and he provided phone numbers. This is inconsistent with an intention to deceive the Board about Mercer's role.

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[184] Fraud involves intentional dishonesty. Repap must show that the fraud was an inducing cause to the contract. If the statements would not have changed the plaintiffs conduct, then they are not material. They must be of a type likely to make the plaintiff act upon it. Only then can it be interred that the defendant had the intent to make the plaintiff act accordingly. In *Hinchey v. Gonda,* Schroeder J. stated the proposition in this way:

> A misrepresentation to be material, must be one necessarily influencing and inducing the transaction and affecting and going to its very essence and substance… The test, therefore, of material inducement is not whether the person's conduct *would,* but whether it *might* have been different if the misrepresentation had not been made.[19]

[185] The best evidence of what the directors relied on is contained in a memorandum dated June 21, 1999, authored by Mr. Cohen, but sent with the approval of the outside directors, except Mr. Dufresne, who had by then resigned. In it, they set out their rationale for approving the Agreement and give four reasons: (1) that the Compensation Committee had done a careful job; (2) that the Mercer report supported the Agreement; (3) that the Agreement was performance based; and, (4) that the Board had taken Mr. Whitman's silence as acquiescence.

[186] As to the first reason, Mr. Berg never represented that the Compensation Committee had done a careful job, but any of the directors could easily have discovered what they had done or not done. I have already mentioned that the memorandum invited the directors to contact Mr. Phillips or himself if they had any questions, but none ever did. Contrary to

[18] Ibid.

[19] (1954), [1955] O.W.N. 125 (Ont. H.C.)

inducing the directors to mistakenly believe there had been a careful review, he invited them to conduct their own due diligence.

[187] There is no persuasive evidence that the directors were induced to approve the Agreement in reliance on Mr. Berg's description of the Mercer opinion in his March 18th memorandum. They took comfort from the existence of the opinion and not from Mr. Berg's representations about it. I have earlier dealt with the third and fourth reasons and do not propose to say anything further, except that nothing Mr. Berg said or did, or failed to say or do, induced a mistaken belief about these matters.

[188] Repap relies on the conduct of Mr. Berg after March 23, 1999, (the "Berg Put", the May 25th Board resolution), as well as the statements he made before and after the approval of the contract, as evidence of fraudulent intention, constituting admissions of improper motive. This evidence has troubled me, but in the end, I am not satisfied that this is evidence of "a wicked mind" that proves Mr. Berg intended to deceive Repap.

[189] When I consider all the evidence, it appears to me that Mr. Berg genuinely, but erroneously believed that he could do some good for Repap. He genuinely, but erroneously believed that he was entitled to be compensated in a grand manner. For his own reasons, Mr. Berg wanted to be Chairman of Repap with a contract that proved he was valuable to it. His entire course of conduct was designed to achieve and preserve this objective. His statements were grandiose, boastful and ill considered. They were intended to intimidate and squelch opposition to the Agreement. He did and said things that were designed to entrench his position. In breach of his fiduciary duties, he at all times put his own interests ahead of the interests of Repap. He was greedy and overreaching and failed miserably in his duties to Repap, but in my opinion, he was not fraudulent.

[190] I conclude that Repap has failed to establish the elements of fraud. Although negligent misrepresentation is pleaded in the alternative, Repap conceded in argument that the facts on which it relies do not fit very well with this cause of action and I agree.

Section 120 of the CBCA

[191] Section 120 of the *CBCA* presumes the invalidity of a contract or transaction between a director or officer and the corporation unless approval of the directors is obtained, the disclosure requirements are met and the contract was reasonable and fair to the company

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when it was approved.[20] The section appears to contemplate that the contract must meet all three parts of the test, but there is little to guide me on its interpretation.

[192] I was referred to two Canadian cases on the meaning to be ascribed to the words “reasonable and fair to the corporation”. In *Rooney v. Cree Lake Resources Corp.,*[21] Dilks J. was called on to interpret the equivalent provision in the *Ontario Business Corporations Act.* He refused to give effect to a “golden parachute” provision in a contract as it would have triggered the payment of unearned compensation in a lump sum equal to over 70 per cent of the corporation’s assets, although there was no reasonable prospect of any sudden influx of capital or income to support the payment. Dilks J. concluded that since such a provision would prevent dissatisfied shareholders from exercising their right to effect a legitimate ouster of what they consider to be incompetent management, this was neither reasonable nor fair to the corporation.

[193] *Cannaday v. McPherson*[22] was also a case that concerned a “golden parachute” provision. Lowry J., sitting in chambers, was required to interpret a provision of the *Alberta Business Corporations Act,* which is similar to section 120(7) of the *CBCA.* On appeal, it was successfully argued that Lowry J. had committed an error by considering only the language of the agreement and he should have had regard to the factual matrix that formed the background to the contract. Mr. Justice Dilks, in *Rooney,* did not have the benefit of the reasons on appeal. Nevertheless, he came to a similar conclusion. He stated:

> In determining whether a particular contract is reasonable and fair to the corporation, one must examine all the surrounding circumstances including the purpose of the agreement and its possible ramifications for the corporation. It need not be either fair or reasonable to the director. It is his fiduciary duty to the corporation which requires it to be fair and reasonable to the corporation.[23]

[194] It seems to me that *Cannaday* stands for a proposition that is already well imbedded in the jurisprudence surrounding the interpretation of a commercial contract. It has been said many times that no contract is made in an vacuum, and the court is obliged to consider its

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[20] *CBCA*, s. 120(7)(a)(b).
[21] *Rooney v. Cree Lake Resources Corp.*, [1998] O.J. No. 3077 (Ont. Gen. Div.)
[22] *Cannaday v. McPherson* (1998), 44 B.C.L.R. (3d) 195 (B.C. C.A.) rev’g (1995), 25 B.L.R. (2d) 75 (B.C. S.C. [In Chambers])
[23] Ibid. at para. 52.

factual matrix when interpreting it.[24] This direction is expressly contained within the language of subsection 120(7)(c) of the *CBCA* itself as it states:

> 120 (7) A contract for which disclosure is required under subsection (1) is not invalid… if
>
> (c) the contract or transaction was reasonable and fair to the corporation when it was approved.

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[195] In view of this, I do not see how one could determine if the contract was reasonable and fair to the corporation when it was approved without considering the circumstances against which it was approved. During the course of these reasons, I have endeavoured to do this.

[196] In *Cannaday,* Lowry J. was dealing with the issue on a summary application where the relevant facts had not been determined. In that case, there were also issues as to the adequacy of the disclosure and the approval, but he found it unnecessary to reach a conclusion on those issues in light of his conclusion that the contract on its face was "wholly one-sided" and neither fair nor reasonable when approved.

[197] The Court of Appeal reviewed the evidence at some length to illustrate that there were matters that ought to have weighed in the balance. In particular, Mr. Cannaday asserted the corporation's chief lender, who had functioned as the controlling mind of the corporation, had knowledge of the contract and had approved it. Mr. Berg relies on this decision, but I do not think it greatly assists him. Here, Repap's largest shareholder knew about the Agreement, but Mr. Whitman was not the controlling mind of Repap and had no direct or indirect involvement in the process that led to the contract or to its ultimate approval. While his apparent lack of opposition is a factor to be considered, it is not determinative, particularly in view of the explanation that he offered for his lack of intervention. Mr. Jensen's resignation letter was intended to make this clear. In any event, Mr. Whitman's views about the Agreement do not support the conclusion that it was fair and reasonable to Repap.

[198] The purpose of section 120 of the *CBCA* is to mitigate the strictness of the common law principle relating to contracts between a director and a corporation. In *Cannaday,* the court appears to be concerned that in setting aside a contract, a party could be unjustly enriched if benefits are obtained for which no consideration is required. I do not regard this as

[24] *Kentucky Fried Chicken Canada v. Scott's Food Service Inc.* (1998), 114 O.A.C. 357 (Ont. C.A.) at 363.

a serious concern here. In any event, a court is normally quite capable of weighing the equities to arrive at a just result. For example, in *Rooney,* the court found the “golden parachute” provision was unenforceable, but then went on to award damages against the corporation for wrongful dismissal.

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[199] I was referred to one American authority, a decision of the Supreme Court of Delaware in *Weinberger v. UOP, Inc.*[25] There, Justice Moore held that the concept of fairness has two basic aspects: fair dealing and fair price. The former embraces questions of when a transaction was timed, how it was initiated, structured, negotiated, disclosed to directors and how the directors’ approval was obtained. In that case, which dealt with minority shareholders’ attack on a cash-at-merger transaction, Moore J. held that the transaction did not meet the requirement for fair dealing, because there were inadequate arm’s length negotiations, a lack of material information in the possession of the Board and undue haste, including a cursorily prepared fairness opinion supporting the transaction in question.

[200] The Agreement in this case is flawed on both counts. Its procedural unfairness is imbued with the same characteristics of unfair dealing referred to in *Weinberger, supra,*— inadequate or, more accurately, non-existent arm’s length negotiations, a lack of material information in the possession of the Board and undue haste, including a cursorily-prepared “reasonableness” opinion supporting the Agreement.

[201] I have already considered in some detail the substantive unfairness of this contract. It created an enormous liability for Repap, without any corresponding benefit to it. It represented excessive dilution for its shareholders, and, like the contract in *Rooney,* it burdened the company with extraordinarily large and unearned cash payments, with the potential to create a financially perilous situation for it.

[202] It is also relevant to consider that Mr. Berg viewed his contract as a liability for Repap that could be useful to him as a negotiating tool when the company was sold or merged. This is further evidence that the contract was not fair and reasonable to Repap. The question is what is to be done about it. I will consider this below.

The Oppression Remedy

[25] *Weinberger v. UOP, Inc.,* 457 A.2d 701 (U.S. Del. S.C. 1983) at 711-712 [13-15 (Lexis)].

[203] The oppression remedy has been a part of the Canadian corporate law landscape since 1975. It is a broad, remedial, curative provision that is designed to protect reasonable shareholder expectations, although the acts complained of may be entirely lawful. The court is concerned with the effect of conduct that is oppressive or unfairly prejudicial or unfairly disregards the interests of any security holder. The court has broad powers under section 241, and there are a variety of orders that can be made, including compensatory orders, or, under subsection 241(3)(h), an order to vary or set aside a contract to which a corporation is a party. It is this remedy that UPM seeks.

[204] The fact that UPM paid a premium for the shares of Repap is irrelevant. UPM does not seek damages. It asks that the Agreement be set aside. If the Agreement stands, UPM is bound by it. As assignee of TDAM's cause of action, and as a shareholder of Repap, it is entitled to ask for an Order setting aside the Agreement if the effect of the conduct complained of unfairly disregards the interests of TDAM and other shareholders.

[205] TDAM had a reasonable expectation that its directors would comply with their statutory obligations to act in good faith and in the best interests of Repap, with due care, diligence and skill. For the reasons I have already given, the process by which the Agreement was negotiated and approved and the terms of the Agreement unfairly disregard the interests of TDAM and other shareholders as a consequence of the conduct of Mr. Berg and of the Board of Directors of Repap. The oppression remedy is available to rectify conduct by directors that amounts to self-dealing at the expense of the corporation or other shareholders.[26] There is no principled reason that it should not also be available to rectify conduct by a Chairman and directors that saddles a corporation with a huge liability and no corresponding benefit to shareholders.

[206] In *820099 Ontario Inc. v. Harold E. Ballard Ltd., supra* at 197, Mr. Justice Farley made this observation about the role of the court when it is asked to "rectify the matters complained of":

> The court should not interfere with the affairs of a corporation lightly. I think that where relief is justified to correct an oppressive type of situation, the surgery should be done with a scalpel, and not a battle axe. I would think that this principle would hold true even

[26] *C.I. Covington Fund Inc. v. White* (2000), 10 C.P.R. (4th) 49 (Ont. S.C.J.) at paras. 21, 40, 41, 43, aff'd (2001), 15 C.P.R. (4th) 144 (Ont. Div. Ct.)

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> if the past conduct of the oppressor were found to be scandalous. The job for the court is to even up the balance, not tip it in favour of the hurt party.

[207] Mr. Berg therefore submits that if a remedy is to be fashioned, the court should revise the employment agreement, and only to the extent necessary to relieve the oppression. He also submits that section 120 should be interpreted consistently with the court's power under section 241 of the *CBCA* and it should vary the Agreement by severing those provisions that are not fair and reasonable.

[208] The setting aside of a self-interested contract can hardly be described as a significant interference in the affairs of a company. In cases of breach of fiduciary duty, disgorgement is a common remedy. I was referred, for example, to the decision in *Sparling c. Javelin International Lteé Internationale Lteé*.[27] There, the court "rectified the matters complained of" by ordering the cancellation of the shares of Mr. Doyle, ordering the removal from office of the Board of Directors of Javelin and amending the articles of association and the by-laws of the corporation to reduce the number of directors. In appropriate circumstances, it seems that courts have not been hesitant to use a heavier hand if this is required to rectify the oppression.

[209] Mr. Berg was at Repap for seven months. His contribution was a modest one, and there is no reliable evidence that he would have or could have contributed a great deal more. In that time, he earned approximately U.S.$200,000. The Chairman who succeeded him was a restructuring specialist who was remunerated at an annual salary in the range of $100,000 to $150,000, with no other benefits. The Chairman who preceded him was not paid. In my view, these are the appropriate comparisons. Measured against them, Mr. Berg was generously compensated for the work he performed.

[210] UPM makes no claim in this action to be reimbursed for the payments Mr. Berg has already received. Setting aside the Agreement would not tip the scale in favour of the corporation. It would leave Mr. Berg with more than adequate remuneration for the services he provided to Repap and would relieve UPM of the obligation of further performance under an unjustified contract that ought never to have been approved. Rectifying the Agreement would tip the scale in favour of Mr. Berg. In any event, there is no adequate evidentiary record upon which I could do this. While the court is encouraged to be creative in fashioning an

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appropriate remedy to cure oppression, there is no need to be creative here. In many ways, this is an easy case because the only parties affected are Mr. Berg, who wishes to retain the benefit of some or all of the contract, and the corporation, who wishes to be relieved of its burden. There are no third party interests at stake.

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[211] The oppression remedy is an equitable remedy and those who wish the court to rectify matters with a scalpel, rather than a battle axe, should give the court some reason to do this. In this case, I can think of no reason why the court should preserve aspects of the Agreement for Mr. Berg, when he had every reasonable opportunity to revise it himself.

[212] He had this opportunity in February when Mr. Larson and Ms. Cormier explained to him why his proposed compensation package was wholly inappropriate. He had another opportunity in early March, when he reviewed the Jensen memorandum and the letters from the directors. Mr. Larson again urged him in May to modify his demands. In early June, with a proxy fight looming and a shareholders' meeting pending, he told Mr. MacLellan that he was amenable to changing the Agreement, or even leaving, but he proposed no terms to him or to the Board. Instead, while Mr. Berg was Chairman, Repap commenced litigation against Mr. Poile, a Repap shareholder, and Mr. McBride.

[213] UPM has satisfied me that it is entitled to a remedy under section 241(3)(h) of the *CBCA.* I conclude that the appropriate remedy in this case is to set aside the Agreement. There are also grounds for doing this under section 120(7) of the *CBCA.*

[214] In the result, the claim is allowed. The crossclaim of Mr. Berg is dismissed. The crossclaim of Repap for a declaration that the employment agreement is unenforceable having been procured through a breach of fiduciary duty is granted, but the balance of the crossclaim is dismissed. If costs are not agreed within 30 days, counsel are directed to arrange a conference call attendance with me. I am greatly indebted to all counsel who presented this case with skill, candour and civility.

Action allowed.

[27] [1986] R.J.Q. 1073 (Que. S.C.).

DATE: 20040220
DOCKET: C38603

COURT OF APPEAL FOR ONTARIO

2004 CanLII 9479 (ON CA)

RE:	**UPM-KYMMENE CORPORATION (Plaintiff (Respondent)) – and – UPM-KYMMENE MIRAMICHI INC., F. STEVEN BERG, CLIFFORD M. SIFTON, STEPHEN W. PHILLIPS (Defendants (F. Steven Berg, Appellant) (UPM-Kymmene Miramichi Inc., Respondent))**
BEFORE:	**ROSENBERG, MACPHERSON JJ.A. and LANE J. (*ad hoc*)**
COUNSEL:	**Sheila Block and Andrew Gray** **for the appellant F. Steven Berg** **R. Paul Steep and Lara Teoli** **for UPM-Kymmene Miramichi Inc.** **Ronald Slaght and Kirsten Crain** **for the respondent UPM-Kymmene Corporation**
HEARD:	**FEBRUARY 16, 2004**

On appeal from the judgment of Justice Joan L. Lax of the Superior Court of Justice dated June 20, 2002, reasons for judgment reported at [2002] O.J. No. 2412 (QL) and [2002] O.J. No. 4137 (QL).

ENDORSEMENT

[1] We agree with the reasons of the trial judge and her conclusion. We add these comments to address certain of the issues raised by the appellant.

[2] The appellant's principal submission was that this was not an appropriate case for the use of the oppression remedy. Counsel for the appellant submits that the oppression remedy should only be available to shareholders who are unable to use the normal corporate

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machinery. She points out that in this case, the aggrieved minority shareholder, TD Asset Management Inc. ("TDAM") was able to join forces with the controlling group and oust the appellant and the Board that had approved the employment contract. She submits that it would then have been open to the new board to sue the former Board members, and presumably the appellant, for negligence. She argues that in the absence of proof of fraud, which the trial judge did not find, it was wrong for the trial judge to grant a rescission remedy.

[3] In our view, the oppression remedy in s. 241 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44, cannot be so limited. There is nothing in the section that would lead the court to read in that limitation. As is pointed out in Dennis H. Peterson, *Shareholder Remedies in Canada*, looseleaf (Ontario: Butterworths, 1989) at §2.36, limiting the oppression remedy to shareholders that do not have majority voting control fails to recognize that "at a fundamental level, [the statutory remedies] address abuse of power in the corporate context." It was open to the trial judge to find that the conduct of the affairs of the company by the appellant and the Board of Directors was oppressive or unfairly prejudicial to, or unfairly disregarded the interests of, the shareholders within the meaning of s. 241 of the Act. As the trial judge said at para. 201, "[T]he oppression remedy is available to rectify conduct by directors that amounts to self-dealing at the expense of the corporation or other shareholders".

[4] We also point out that this limitation on the availability of the oppression remedy was not argued at trial. Rather, the focus of the trial was on whether the appellant had breached his fiduciary duty to the company and whether the decision of the Board fell within the parameters of the business judgment rule. The trial judge made findings of fact that support her conclusions that the appellant breached his duty to the company, that the process by which the Board came to approve the contract was seriously flawed, and that the Board's decision fell outside the range of reasonableness.

[5] While the appellant did not seriously challenge the trial judge's findings of fact, counsel submits that the trial judge, in effect, substituted her view of the reasonableness of the compensation package for that of the Board. It is argued that she subjected the contract and the procedure that led to its approval to a microscopic *ex post facto* examination. The appellant submits that a better measure of the reasonableness of the contract is the view of the experienced board member, Mr. Cohen, who was one of the members of the Board that approved it, and the view of Mr. Whitman, who represented the controlling shareholder and made no comment about the contract.

[6] We do not agree with this characterization of the trial judge's reasons. The trial judge was well aware that the court is not entitled simply to second-guess the Board's decision. As the trial judge said, the court looks to see whether the Board made a reasonable decision, not a perfect decision. She stated that the business judgment rule "recognizes the autonomy and integrity of a corporation and the expertise of its directors" since they are "in the advantageous position of investigating and considering first-hand the circumstances that come before it and are in a far better position than a court to understand the affairs of the corporation and to guide its operation". [Reasons para. 152.]

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[7] As we have said, the process by which the Board members came to make their decision was seriously flawed. As just one example, the Board relied upon the recommendation of the compensation committee but that committee did not have the time or expertise to review the contract and its members did not understand its key components. The trial judge found at paragraph 156 that the process leading up to the meeting and proceedings at which the contract was approved "fell far short of the exercise of prudent judgment in the interests of the shareholders that is expected of directors". This finding is supported by the evidence.

[8] At paragraph 193 of her reasons, the trial judge expressly referred to Mr. Whitman's silence. She was entitled to take into account his explanation for his silence. Further, as she pointed out, the resignation of Mr. Jensen, Mr. Whitman's nominee, was intended to make clear Mr. Whitman's disapproval of the contract.

[9] We would not give effect to the submission that the oppression remedy should be limited to circumstances in which the shareholders have no other remedy, nor would we give effect to the submission that the trial judge substituted her view of the reasonableness of the compensation package for that of the Board.

[10] The appellant also submits that the plaintiff purchased the shares of Repap with full knowledge of the contract and that TDAM was able to sell its shares at a premium. Thus, it is submitted there is nothing to show that either the plaintiff or TDAM was oppressed. The trial judge addressed this issue in paragraph 200 of her reasons:

> The fact that UPM paid a premium for the shares of Repap is irrelevant. UPM does not seek damages. It asks that the Agreement be set aside. If the Agreement stands, UPM is bound by it. As assignee of TDAM's cause of action, and as a shareholder of Repap, it is entitled to ask for an Order setting

> aside the Agreement if the effect of the conduct complained of unfairly disregards the interests of TDAM *and other shareholders.* [Emphasis added.]

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[11] We agree with that conclusion and would not give effect to this submission. In light of our conclusion that the trial judge properly invoked the oppression remedy, we need not consider the application of s. 120 of the Act.

[12] The appellant sought leave to appeal the costs order in favour of Repap Enterprises Inc. (UPM-Kymmene Miramichi Inc.) because this respondent failed to prove fraud as alleged in its cross claim, which allegation it maintained at trial. The appellant relies upon the statements of Blair J. in *Bargman v. Rooney* (1998), 30 C.P.C. (4th) 259 (Ont. Gen. Div.) at paras. 18 and 19:

> It matters not, in my view, at what stage in the proceedings the unproved allegations are levelled. Because of their extraordinarily serious nature - going, as they do, directly to the heart of a person's very integrity - allegations of fraud and dishonesty are simply not to be made unless there is every reasonable likelihood that they can be proved. The cost sanction exists in these circumstances to help ensure that such will be the case.
>
> …
>
> The cost sanction should be imposed sharply and firmly by the Courts, in my opinion, at any stage in the proceedings when unsupported and unproven allegations of fraud and dishonesty are put forward.

[13] The trial judge was aware of the normal rule that a successful plaintiff who has failed to establish fraud should be deprived of its costs. The trial judge provided reasons for exercising her discretion in favour of the respondent. We have not been persuaded that she erred in so doing. In this case there was “every reasonable likelihood” that the allegations of fraud would be made out. As it was, the trial judge found that the appellant made false allegations against Mr. Cohen, that his motive for the “Berg Put” was entirely improper, that he threatened to collapse the company’s capital structure if his wishes were not carried out, that he completely lost sight of his obligations to the company, that he “failed utterly” in his duties to the company, that his conduct was “exactly opposite to the conduct that the law

required of him as a fiduciary", and that he was "greedy and overreaching and failed miserably in his duties to Repap". Accordingly, leave to appeal costs is refused.

[14] The appeal is dismissed with costs fixed as follows:

> To the respondent UPM-Kymmene Corporation: $39,138.15
> inclusive of disbursements and G.S.T.
>
> To the respondent UPM-Kymmene Miramichi Inc.: $27,245.75
> inclusive of disbursements and G.S.T.

Signed: ____ "M. Rosenberg J.A."

_____ "J.C. MacPherson J.A."

_____ "D. Lane J."

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TAB 6

Court of Queen’s Bench of Alberta

Citation: Zysko v. Thorarinson, 2003 ABQB 911

Date: 200311007
Docket: 0201 01475
Registry: Calgary

IN THE MATTER of an intended action pursuant to
Section 234 of the *Business Corporations Act*
R.S.A. 1980, chapter B-14 as amended

IN THE MATTER of E.S.J. Equities Inc.,
a company incorporated under *The Business Corporations Act*

Between:

Joseph Zysko and ES’J Developments Ltd.

Applicants

- and -

Eugene Thorarinson, Sally Thorarinson
and Bluebird Springs Inc.

Respondents

Memorandum of Decision
of the
Honourable Mr. Justice P. Chrumka

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[1] The respondents apply pursuant to sections 115-121, 234 and Part 19 of the **Business Corporations Act** R.S.A. 1980, c. B-14 as amended for an order:

1. Declaring that the Resolutions passed by the Board of Directors of E.S.J. Equities Inc. at the meeting of the Board of Directors held on January 14, 2002 are valid and binding resolutions of the company and are in full force and effect;

2. Declaring that the Mortgage granted by E.S.J. Equities in favour of BlueBird Springs Inc. dated December 18, 2001 and registered as instrument number 012418270 on December 31, 2001 (the "Mortgage") is a valid and binding mortgage properly granted by E.S.J. Equities Inc. to BlueBird Springs Inc.;

3. Declaring that the General Security Agreement executed by ESJ Equities Inc. in favour of BlueBird Springs Inc. dated December 18, 2001 is valid and binding;

4. Declaring that the sum of $476,944.19 is due and owing by E.S.J. Equities Inc. to BlueBird Springs Inc. pursuant to the Mortgage and the said General Security Agreement;

5. Directing the Clerk of the Court to pay all the sum of $400,768.31 plus all interest earned thereon to the solicitor for BlueBird Springs Inc. in partial payment of the monies secured by the Mortgage and the said General Security Agreement;

6. Directing the balance of proceeds from the sale of 19 Beardsley Avenue, Lacombe, Alberta to be paid to BlueBird Springs Inc. after payment of any additional legal fees relating to the sale of the said property and after payment of the account of Ken Erickson;

7. In the alternative, determining the rights of BlueBird Springs Inc. and ES'J Developments Ltd. to the funds presently held on deposit pursuant to the order of Justice Nation granted on July 19, 2002 and pursuant to a Unanimous Shareholders Agreement dated July, 2000 and directing the Clerk of the Court to disburse the said funds in a manner to be determined by this Honourable Court;

8. For costs of the within action on a solicitor and his own client basis or pursuant to Schedule C of the Alberta Rules of Court;

HISTORY

[2] E.S.J. Equities Inc. ("E.S.J. Equities" or "Corporation") is an Alberta corporation which was incorporated on May 23, 2000. The shareholders initially were Joseph Zysko - 50% of the issued shares; Sally Thorarinson - 25%; Eugene Thorarinson - 25%. Eugene and Sally Thorarinson are husband and wife.

[3] Joseph Zysko is the sole shareholder of ES'J Developments Ltd. ("ES'J Developments"); Sally Thorarinson is the sole shareholder of the voting shares of Bluebird Springs Inc. ("Bluebird").

[4] On June 28, 2000 in a Letter of Intent E.S.J. Equities acquired land from Canadian University College ("CUC"). This Letter of Intent obligated E.S.J. Equities to develop, construct, own and manage a 19 unit apartment complex on the land acquired in Lacombe, Alberta ("Apartment").

[5] Prior to any agreements being executed by the parties, David Goldenberg, a lawyer, and Mushtaq Thobani, the accountant for Sally and Eugene Thorarinson, recommended that it would be more advantageous if the shareholders of E.S.J. Equities owned their shares through their respective holding companies. Accordingly, ES'J Developments became the holder of 50% of the issued shares of E.S.J. Equities and Bluebird became equally a 50% shareholder of E.S.J. Equities.

[6] ES'J Developments was to act as Project Manager/Contractor for the construction of the apartment (the "Project").

[7] E.S.J. Equities was to arrange the financing to construct the apartment ("Financing").

[8] E.S.J. Equities was to receive revenue generated from the rental of the apartment upon completion of its construction.

[9] A Unanimous Shareholders Agreement was entered into effective July 1, 2000 between Bluebird Springs Inc., ES'J Developments and E.S.J. Equities.

[10] The signatories to the Unanimous Shareholders Agreement were Sally Thorarinson for Bluebird and ES'J Developments, and Sally Thorarinson and Joseph Zysko for E.S.J. Equities.

[11] Certain financing for the Project was put in place; namely, Bluebird injected $177,689.55 for use in the Project ("Bluebird funds") and L.M. Thorarinson Ltd. injected $150,000 (the "Lars funds").

[12] The Lars funds was to be repaid with interest as soon as possible out of conventional financing that E.S.J. Equities was to obtain. Additionally, it was agreed that the Bluebird funds plus an additional $52,310.45 would be injected by Bluebird into the Project and this was to be considered as Bluebird's equity contribution. Additionally, Bluebird was to cause Eugene Thorarinson to "provide sufficient collateral necessary for the corporation E.S.J. Equities to obtain long term institutional financing for the Project on terms and conditions that are satisfactory to all parties."

[13] The Unanimous Shareholders Agreement in para. 5 provides:

> It is further acknowledged and agreed that the project management services as well as any savings in the Project construction which results from Developments efforts shall be considered to be Developments equity contribution into the

> Project. No interest shall be payable by the Corporation to Developments on its equity contribution.

[14] In para. 8, it specifically provides:

> The parties acknowledge, that as the sole shareholders of the Corporation, they have agreed on the following matters relating to the Apartment:
>
> (a) No sale of the Apartment shall take place without the consent of all of the shareholders;
>
> (b) No financing shall be taken out against the Project or the apartment without the express consent of all of the parties hereto; (emphasis added)
>
> (c) All material or important decisions relating to the ongoing ownership, operation or management of the apartment shall require the consent of all shareholders;

[15] In para. 12 it provides:

> This Agreement shall be considered a Unanimous Shareholder Agreement of the shareholders of the Corporation passed in accordance with the provisions of the Business Corporations Act (Alberta).

[16] Construction of the Apartment began in July, 2000. It was expected it would be completed within six months. It was delayed by reason of financing problems but it was sufficiently completed by September 7, 2001 and thus an interim occupancy permit was issued by the Town of Lacombe for all units excluding the basement units.

[17] Community Credit Union Ltd. (the “Credit Union”) in January, 2001 approved the granting of credit facilities to E.S.J. Equities to complete construction of the Apartment. The Credit Union agreed to lend $1,007,500 to E.S.J. Equities.

[18] During the summer of 2001, there was a dispute between Bluebird and ES’J Developments regarding accounting issues relating to the cost of developing and constructing the Apartment. Additionally, there were issues concerning the leasing of the units in the Apartment and the revenue generated therefrom.

[19] The affidavit evidence from Sally Thorarinson is that she and her husband Eugene Thorarinson became very concerned about their investment in the Apartment and the financial sistuation of E.S.J. Equities. Sally and Eugene Thorarinson decided to secure their investment in E.S.J. Equities and as two of the three Directors of E.S.J. Equities they granted a mortgage and other security in the sum of one millions dollars; the borrower being E.S.J. Equities Inc and the lender being Bluebird Springs Inc. The mortgage was executed by E.S.J. Equities per Sally

Thorarinson and Eugene Thorarinson. It was registered against the title to the land on the 31st of December, 2001. Additionally, a caveat with respect to the assignment of rents to the caveator Bluebird Springs Inc. was also registered on that same day. On the 4th of January, 2002 a Notice of Security Interests re fixtures in favour of Bluebird Springs Inc. was filed against the land.

[20] Eugene Thorarinson and Sally Thorarinson estimated that approximately $600,000 had been invested by Bluebird in the Project, all of which was unsecured. They estimated that the total amount of the current and future loans to E.S.J. Equities would be in the amount of one million dollars and therefore the mortgage was in that amount. This was done without prior notice being given to Joseph Zysko.

[21] Joseph Zysko, the third Director of E.S.J. Equities did not agree to any financing on the Apartment other than the mortgage provided to E.S.J. Equities by the Credit Union.

[22] To further secure Bluebird’s interest, a general security agreement was enacted on December 18, 2001 between E.S.J. Equities as debtor and Bluebird Springs Inc. as secured party. E.S.J. Equities executed the agreement per Sally Thorarinson, Director-President and Eugene Thorarinson, Director and Bluebird Springs Inc. per Sally Thorarinson, Director-President.

[23] A Notice of a Meeting of the Board of Directors of E.S.J. Equities Inc. (the “Corporation”) was prepared calling for a meeting of the Board of Directors of E.S.J. Equities to be held at the respondent’s lawyer’s office on Monday, January 14th, 2002. This notice was dated the 8th day of January, 2002 and is signed by Sally Thorarinson, President and Director. The notice was issued pursuant to “Division Five, By-Law numbers 5.01 and 5.02 of the By-law Number One” of E.S.J. Equities. It did not specify or indicate the reason for the meeting.

[24] By-Law Number One of E.S.J. Equities was enacted on May 23, 2000. The sole signatory to the enactment was Sally Thorarinson as President and also as Secretary. In Division Two, para. 2.01 thereof E.S.J. Equities borrowing power is set out. In part it provides:

> 2.01 Borrowing Power: Without limiting the borrowing powers of the Corporation as set forth in the Act, but subject to the articles and any unanimous shareholder agreement, the board may from time to time on behalf of the Corporation, without authorization of the shareholders:
>
> (a) borrow money upon the credit of the Corporation;
>
> ...
>
> (d) mortgage, hypothecate, pledge or otherwise create a security interest in all or any currently owned or subsequently acquired real or personal, moveable or immoveable, property of the Corporation including book debts, rights, powers, franchises and undertakings, to secure any such bonds, debentures, note or other evidences of

> indebtedness or guarantee or any other present or future indebtedness, liability or obligation of the Corporation.

[25] A further by-law, namely By-Law Number Two, was enacted on the same day. Again, the sole signatory was Sally Thorarinson. This By-Law authorized E.S.J. Equities to borrow and pledge as follows:

> 1. That the Directors of the Corporation may from time to time:
>
> (a) Borrow money upon the credit of the Corporation by obtaining loans or advances or by way of overdraft or otherwise;
>
> ...
>
> (c) assign, transfer, convey, hypothecate, mortgage, pledge, charge, give security in any manner upon all or any of the real or personal or immoveable property, rights, powers, choses in action, or other assets, present or future, of the Corporation to secure any such securities or other securities of the Corporation or any money borrowed or to be borrowed or any obligations or liabilities as aforesaid or otherwise of the Corporation heretofore, now or hereafter made or incurred directly or indirectly or otherwise; and
>
> ...
>
> 2. That any or all of the foregoing powers may from time to time be delegated by the Directors to any one of (sic) more of the Directors or Officers of the Corporation.
>
> 3. That this By-Law shall remain in force and be binding upon the Corporation as regards any person acting on the faith thereof until such person has received written notification from the Corporation that this By-Law has been repealed or replaced.

[26] Joseph Zysko did not delegate any of the powers he had under either By-Law Number One or By-Law Number Two to either Sally Thorarinson or Eugene Thorarinson the two other Directors of E.S.J. Equities.

[27] The meeting of the Board of Directors was held on the 14th of January, 2002. The three Directors present were Sally Thorarinson, Eugene Thorarinson and Joseph Zysko. These were all of the Directors of E.S.J. Equities. A Resolution of the Directors was passed by the majority, namely Sally Thorarinson and Eugene Thorarinson. A certified copy of the Resolution of the Directors is Exhibit "F" to the affidavit of Sally Thorarinson, sworn on the 21st of November, 2002. The Resolution was a very sweeping resolution. In part it provided:

> 2. The granting of security Bluebird Springs Inc. (“Bluebird”) for the purpose of securing a loan or loans made by Bluebird to the Corporation up to $1,000,000.00 which security includes, without limitation, a Demand Promissory Note, Mortgage, Assignment of Rents, and General Security Agreement, be authorized, approved and ratified.
>
> 3. The execution and delivery of all security documents in favour of Bluebird on behalf of the Corporation by Sally Thorarinson and Eugene Thorarinson be authorized, approved and ratified.
>
> 4. The Corporation authorize and approve the immediate appointment of Ken Erickson to manage the apartment building owned by the Corporation located at 19 Beardsley Avenue, Lacombe, Alberta (the “Apartment”) and, without limitation, such management will include collection of all rent from tenants in the Apartment, entering into lease agreements with tenants, administering all tenant leases, and maintaining the Apartment and authorizing the Corporation to enter into an (sic) written agreement with Ken Erickson for such purpose.
>
> 5. The Corporation authorize and approve the granting of security to Riverton Construction Ltd. to secure repayment of its loan of approximately $300,000.00 and to authorize Sally Thorarinson and Eugene Thorarinson to execute and deliver any security and other documents reasonably required to effect such transaction.

[28] In paras. 8 through to 13 inclusive, all authority that Joseph Zysko had with respect to the Project and the Apartment was terminated.

[29] Para. 14 required Joseph Zysko to deliver to the Corporation within 14 days of the date of the meeting or such reasonable period of time as Sally and Eugene Thorarinson might agree, all records concerning the Project and the construction of the Apartment.

[30] Para. 15 authorized Sally Thorarinson to open a bank account on which she and her husband would be the signing officers with respect to that account. The Resolution is signed by Sally Thorarinson as President. The Certificate of the Resolution states:

> I, the undersigned President of **E.S.J. Equities Inc.** hereby certify that the foregoing is a true copy of a resolution of the directors of that Company passed at a meeting of the directors duly called and held on the 14th day of January, 2002, which Resolution is in full force and effect and unamended at the date hereof. (Emphasis added)

[31] It is noted that the Resolution is a resolution of only two of the Directors of E.S.J. Equities and not the third, Joseph Zysko.

[32] On the 24th of January, 2002 Joseph Zysko and ES'J Developments applied for an ex parte interim order with respect to the Resolution and its effect. The respondents were Eugene Thorarinson, Sally Thorarinson and Bluebird Springs Inc. Madam Justice Rawlins ordered:

> 1. The Respondents and their solicitor, Brian Silver, are hereby restrained and enjoined from unilaterally dealing with the property, assets and undertaking of the Company without consent or agreement of the Applicants, pending further Order of the Court.
>
> 2. All business to be conducted by or on behalf of the Company and any contract or agreement to be executed for on behalf of the Company shall require two signatures, being the signature of Joseph Zysko and one of the signatures of Eugene Thorarinson or Sally Thorarinson, pending further Order of the Court.
>
> 3. The banking resolutions of the Company shall hereinafter require two signatures, being the signatures of Joseph Zysko, and one of the signatures of Eugene Thorarinson or Sally Thorarinson, pending further Order of the Court.
>
> 4. All cheques, and other negotiable instruments or other securities relating to E.S.J. Equities Inc. after January 24, 20002 shall require two signatures, being the signatures of Josef (sic) Zysko and one of the signatures of Eugene Thorarinson or Sally Thorarinson, pending further Order of the Court.
>
> 5. The existing status of the property, assets and undertaking of the Company shall be preserved pending further Order of the Court.
>
> 7. Pending further Order of the Court, the Resolutions passed at the purported Director's Meeting held on January 14, 2002 at the offices of Brian Silver, including the purported eviction of the Applicant, Joseph Zysko from his residence on the company's property in Lacombe, Alberta, are of no force and effect.
>
> 8. The Hearing of the Originating Notice herein shall be adjourned and shall be set down upon 3 day's (sic) notice to the parties or their respective legal counsel.
>
> 9. The Interim Order shall be spoken to in Chambers on January 31, 2002. Either party is at liberty to apply for any amendment, variation or vacation at that time.

[33] The applicants Joseph Zysko and ES'J Developments made their application pursuant to s. 234 of the **Alberta Business Corporations Act** R.S.A. 1980, c. B-14 by filing an Originating Notice of Motion on the 24th of January, 2002. The **Act** is cited incorrectly. The **Act** is the **Business Corporations Act** S.A. 1981, c. B-15 s. 234 (the "**Act**").

[34] There followed numerous applications and Court orders. On January 31, 2002 Mr. Justice Waite granted an Interim Order ordering that E.S.J. Equities appoint Ken Erickson, a licensed real estate agent, as an independent third party property manager to property manage the rental assets of E.S.J. Equities, including the collection of rents, payment of expenses and leasing matters pending further order of the Court. His Lordship further ordered that the order of Madam Justice Rawlins granted on the 24th of January, 2002 would remain in full effect and force pending further Order of the Court.

[35] On February 8, 2002 I granted an Interim Consent Order requiring Joseph Zysko and ES'J Developments to deliver a full, complete and detailed accounting of all rent collected from September 1, 2001 to January 31, 2002 to the respondents.

[36] My Order apparently was not complied with and on the 17th of May, 2002 Madam Justice Phillips granted an order citing Joseph Zysko and ES'J Developments in contempt and ordered the two parties to deliver the accounting to the respondents by June 30, 2002.

[37] On May 28th, 2002 Mr. Justice Brooker, upon the application of the respondents, directed that the respondents obtain an appraisal from a qualified, independent appraiser for the purposes of determining the value of the Apartment owned by E.S.J. Equities.

[38] On July 8, 2002 Mr. Justice Lomas heard a further application by the respondents to have Joseph Zysko and ES'J Developments cited in contempt. The application was adjourned to the 26th of August, 2002. If Joseph Zysko and ES'J Developments failed to serve the affidavit as previously ordered then the respondents were granted leave to immediately apply to the Court for an Order to incarcerate Joseph Zysko for contempt.

[39] On July 19, 2002 Madam Justice Nation granted an Order that among other things directed the Apartment to be sold to Riverton Construction Ltd. for $1,460,000. The Order also provided directions with respect to the disbursement of the sale proceeds to the various parties named therein. Madam Justice Nation directed that the balance of the sale proceeds were to be paid to the Clerk of the Court to be held and invested by the Clerk of the Court in an interest bearing account pending further Order of this Court.

[40] On September 2nd, 2002 the Apartment was sold to Riverton Construction Ltd. for $1,460,000. The shareholders of Riverton Construction Ltd. are Eugene Thorarinson and his two brothers, John and Lars Thorarinson. The funds realized from the sale of the Apartment net of the monies owed to the Community Credit Union and the lien claimants and paid into Court was $400,768.31. This money was paid in by the lawyer for E.S.J. Equities.

[41] Joseph Zysko and ES'J Developments have not been represented by a lawyer since May, 2002.

ACCOUNTING BY JOSEPH ZYSKO AND ES'J DEVELOPMENTS

[42] It is submitted by Eugene Thorarinson, Sally Thorarinson and Bluebird Springs Inc. ("respondents") that they have not been provided with an accounting as ordered by myself notwithstanding the subsequent Court Orders requiring them to do so. It is submitted that some photocopies of cheques have been delivered as well as deposit books and ledgers pertaining to the revenue for the Apartment. It is further submitted that the information the respondents lack concerns:

a. The actual costs of the development and construction of the Apartment;

b. Identities of and amounts owing to sub-trades pertaining to the development and construction of the Apartment;

c. Amount of revenue earned by E.S.J. Equities from the tenants of the Apartment during the period September 1, 2001 to January 31, 2002;

d. Amount of savings, if any, accomplished by the applicants as a result of ES'J Developments' Project management during the development and construction of the Apartment?

e. The amount of the money paid to Joseph Zysko or ES'J Developments from funds received from or through E.S.J. Equities, Bluebird, Sally or Eugene Thorarinson with respect to the subject Project; and

f. The amount of money received or retained by the applicants from the revenues generated from the Apartment.

ISSUES

[43] It is submitted that there are three issues to be determined in this application:

1. To determine the validity of the mortgage and other security granted to Bluebird by E.S.J. Equities in December, 2001.

2. To determine the amount of money owing to Bluebird by E.S.J. Equities.

3. To determine the entitlement of Bluebird and ES'J Developments to the $400,768 and interest representing the net sale proceeds from the sale of the Apartment.

BORROWING POWERS OF E.S.J. EQUITIES

[44] The provisions of the **Business Corporations Act** RSA 2000, c. B-9 (which came into force January 1, 2001) and By-Laws Number One and Number Two of E.S.J. Equities govern the affairs of E.S.J. Equities. The relevant provisions of the **Business Corporations Act** in force prior to the recent revision are worded similarly to the present **Act**. The sections are, however, numbered differently at present.

[45] The initial financing for the Project required Bluebird to inject $177,689.55 for use in the Project and then later to inject a further $52,310.45. This $230,000 was to represent Bluebird's equity contribution in the Project. Additional financing was $150,000 from L.M. Thorarinson Ltd. This money was to be repaid, plus interest, as soon as possible out of conventional financing the corporation was to obtain. During the construction of the Project further money was injected by Bluebird.

[46] Mushtaq Thobani, the accountant for Sally Thorarinson, calculated the Bluebird investment in the Project and according to his records Bluebird invested $903,869.41 in E.S.J. Equities and of this, $426,925.22 was repaid leaving a balance due to Bluebird Springs of $476,944.19. Included in the investment is a cheque No. 45 dated 05-31-06 payable to Fraser Milner and Casgrain in the sum of $100,000. This does not appear to be an expense incurred by E.S.J. Equities.

[47] In her Supplemental Affidavit sworn the 27th day of February, 2003 Sally Thorarinson deposes in para. 7 that Bluebird paid $100,000 to Fraser Milner. In para. 9 she deposes that this represented payment of a portion of $150,000 which had been deposited to purchase additional lands from the Canadian University College and, further, that the $150,000 deposit was returned by Fraser Milner and is reflected in the Schedule of Funds prepared by Mr. Thobani. Therefore the repayment in effect was $150,000 from Fraser Milner representing a refund of deposit monies on the incomplete purchase of the land from the Canadian University College and $276,925.22 to Bluebird of the funds it had advanced.

[48] The $903,869.22, the total sums paid by Bluebird includes Bluebird's $230,000 equity payment. This equity payment is not recoverable by Bluebird as it was an equity payment and not a loan to E.S.J. Equities.

POSITION OF THE RESPONDENTS

[49] The respondents submit that the mortgage granted by E.S.J. Equities to Bluebird for the purpose of securing monies advanced or to be advanced to E.S.J. Equities by Bluebird with respect to the development, construction and management of the apartment in Lacombe was not a contract or a material contract but that it was security for repayment of monies advanced. All that was being done was changing the nature of the indebtedness from unsecured to secured.

[50] The respondents further submit that the Bluebird security which included the Mortgage and the Promissory Note and Security Agreement was executed by the Directors of Bluebird and E.S.J. Equities acting in their capacities as Directors. It is further submitted that the Directors' Meeting held on January 14, 2002 was held on Notice to all of the Directors with a quorum present and accordingly, the resolutions passed and the approval authorization and ratification of the Bluebird security was in compliance with the powers and duties that the Directors enjoyed. It was therefore submitted that the Bluebird security had been validly granted by E.S.J. Equities.

[51] The respondents further submit that the granting of the Bluebird security was not in breach of the Unanimous Shareholders Agreement as the Mortgage or other security in favour of Bluebird was not covered by the word "financing" as used in para. 8(b) of the Unanimous Shareholders Agreement. It is therefore submitted that the granting of the Bluebird security does not constitute a breach of the Unanimous Shareholders Agreement.

[52] It is further submitted that the powers exercised by Sally and Eugene Thorarinson as Directors of the two corporations were not exercised in the way that was oppressive, unfairly prejudicial or unfairly disregarding the interest of Joseph Zysko or ES'J Developments

[53] The respondents submit that Bluebird is entitled to the recovery of the full amount plus interest of the monies in Court.

POSITION OF THE APPLICANTS

[54] The applicants submit that not only did they provide the services required under the Unanimous Shareholders Agreement, they injected certain funds to facilitate the construction of the Apartment.

[55] Joseph Zysko submits that he did not consent to the Mortgage, he did not delegate his authority as a Director to anyone and therefore the Mortgage is invalid as is the Resolution.

THE MORTGAGE

[56] The Mortgage entered into by Bluebird and E.S.J. Equities is not only a contract but also a material contract as that term is used in s. 120(1)(a) of the **Business Corporations Act**.

[57] In ***Frado*** v. ***Bank of Montreal*** , [1984] A.J. No. 706, Master Funduk in para. 12 held:

> A mortgage, be it the common law mortgage, the statutory mortgage or an equitable mortgage, is a contract.

[58] In ***Royal Bank of Canada*** v. ***Boyd (Trustee of)***, [1991] A.J. 1276, Hutchinson, J. quoted in para. 8 Justice MacDonald's reference to **Halsbury**:

> In equity a mortgage is created by a contract evidenced in writing for valuable consideration to execute, when required, a legal mortgage, or by a contract so evidenced and for valuable consideration that certain property is to stand as a security for a certain sum.

[59] In ***Yarley (China) Developments Co.*** v. ***Amber Equities Inc.***, [1996] 10 W.W.R. 479, Master Funduk at para. 115 stated:

> A mortgage is a contract. Among other things it gives the mortgagee a charge on the land. But that is not all that it is. The charge does not exist in a vacuum. It is a charge given to secure a debt or loan. That is the statutory definition.

[60] Section 120 the **Business Corporations Act** provides:

> 120(1) A director or officer of a corporation who
>
> > (a) is a party to a material contract or proposed material contract with the corporation, or
> >
> > (b) is a director or an officer of or has a material interest in any person who is a party to a material contract or proposed material contract with the corporation,
>
> shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of the director's or officer's interest.
>
> ...
>
> (6) A director referred to in subsection (1) shall not vote on any resolution to approve the contract unless the contract is
>
> > (a) an arrangement by way of security for money lent to or obligations undertaken by the director, or by a body corporate in which the director has an interest, for the benefit of the corporation or an affiliate,
>
> ...
>
> (7) For the purpose of this section, a general notice to the directors by a director or officer is a sufficient disclosure of interest in relation to any contract made between the corporation and a person in which the director has a material interest or of which the director is a director or officer if

> (a) the notice declares the director is a director or officer of or has a material interest in the person and is to be regarded as interested in any contract made or to be made by the corporation with that person, and states the nature and extent of the director's interest,

[61] The term material as used in s. 120(1)(a) is not defined in the legislation. Section 120(1)(a) of the Alberta's **Business Corporations Act** is virtually identical to the same section in the **Canada Business Corporations Act**.

[62] In ***UPM-Kymmene Corp***. v. ***UPM-Kymmene Miramichi Inc.*** (2002), 214 D.L.R. (4th) 496 at 545, paragraph 187, Mr. Justice Lax noted:

> Section 120 of the *CBCA* presumes the invalidity of a contract or transaction between a director or officer and the corporation unless approval of the directors is obtained, the disclosure requirements are met and the contract was reasonable and fair to the company when it was approved.

And, at page 547, paragraph 194:

> The purpose of section 120 of the *CBCA* is to mitigate the strictness of the common law principle relating to contracts between a director and a corporation.

[63] In ***McAteer*** v. ***Devoncroft Developments Ltd.***, 2001 ABQB 917, (2001), 99 Alta. L.R. (3d) 6 Rooke, J. considering whether certain transactions were material refers to two authorities. Firstly, at p. 92, para. 309:

> Professor B.L. Welling in Corporate Law in Canada: The Governing Principles, 2nd ed. (Vancouver: Butterworths, 1991), discussed the issue of what interests are "material". At 452 - 453, he stated:
>
> > . . . it seems clear that the statute also addresses the problem of a director or officer who has no monetary interest in a person on the other side, yet who is likely to have an emotional involvement. Thus, a deal in which the corporation is negotiating with a close relative, or even a close personal friend, of one of the directors or officers ought to be suspect. ...one can assume that the courts will address their attention to the blood relation question... the only question will be to what degree of relationship the section extends. The answer is once again, subsumed under the requirement that the interest itself be "material".
> >
> > What is meant by "material".... In the context of conflict of interest contracts, the meaning of "material contract" and "material interest" is conditioned by the purpose behind the section. The purpose is to identify those negotiations in which a corporate manager's ability to bargain

> > effectively on behalf of the corporation may be inhibited by some interest he has in the other side. Any personal relationship or monetary interest he may have in the other side that might be thought to be an inhibiting factor is a material interest if disclosure of the relationship or interest might be relevant to the corporate decision whether to involve the particular manager in the negotiations. Whether to participate in a proposed contract is a corporate decision and the corporation is entitled to full disclosure from its fiduciaries of all facts that might affect that decision. This point is reflected in a 1952 judgment... [Gray]

And para. 310:

> D. Peterson, in Shareholder Remedies in Canada (supra), also discussed the meaning of "material". At paragraph 13.15 he wrote:
>
> > ... the meaning of material is important in determining whether compliance with [the statute] is required where the director has an interest in some other person that is contracting with the corporation. As working rules to determine whether or not a material interest exists, it is submitted that an assessment of control and benefit ought to be made. If the director or officer has the ability to cause the person in question to enter into the contract with the corporation, the director has a "material interest" in the transaction. The conflict of interest is clear and the nature of the circumstances must be disclosed.

[64] Mr. Justice Rooke concludes at para. 311, with his finding of whether the impugned party had a material interest:

> Given my finding that Billes exercised de facto control over the Trust and that her son was the beneficiary thereof, I find that Billes had a material interest in the Trust Loan despite the fact that she did not have a personal, financial interest in the Trust. Perhaps even more important, as one of three legal entities constituting the Trust, she is "a party" to the Trust Loan under section 115(1)(a).

[65] In ***Dimo Holdings Ltd.*** v. ***Jager Developments Inc.*** (1998), 43 B.L.R. (2d) 123 (Alta. Q.B.), Justice Fruman discussed the concept of material:

> That term is not defined in the *ABCA*. Presumably it is a broad concept. It denotes a financial interest, but to be material it must be more than insignificant. It is a question of fact in each case. The term would include a material beneficial interest, possibly it would even include an interest in which an individual could exercise discretion or control over sufficient shares so as to affect the financial outcome of a company. [...] Frequently funds are paid to intermediaries, such as

> solicitors in trust for a party, and that hardly qualifies them as having a material interest. Something more is required.

[66] The authorities, in my view, disclose that the term “material” is a question of fact that extends beyond the more commonly held notion of financially material. In my view, what is meant by material contract is that if there is a possibility that the Director was to benefit from the contract more than *de minimis* then the transaction should be disclosed to the corporation. Professor Welling states what may be a good rule of thumb: there should be disclosure whenever the director or officer’s involvement might be relevant to the corporation’s decision making process. This would appear to mean that if the corporation would undertake additional due diligence to determine whether the contract or any of its terms is truly in its best interest or if it would assign another director or officer to handle the negotiations, then the contract is material and must be disclosed.

[67] In this case there was no disclosure of the mortgage and financial security to Joseph Zysko or ES’J Developments until the Directors’ meeting. All of the documentation had been prepared at the instance of Sally and Eugene Thorarinson, the Directors of Bluebird and E.S.J. Equities. The signatories to the Mortgage are husband and wife, each of which had a special financial interest in Bluebird and in the Bluebird security.

WAS THE EQUITY GRANTED TO BLUEBIRD IN BREACH OF THE UNANIMOUS SHAREHOLDERS AGREEMENT

[68] In paragraph 8, the Unanimous Shareholders Agreement provided that the parties acknowledged as being the sole shareholders of E.S.J. Equities, that no financing would be taken out against the Project or the Apartment without the express consent of all of the parties to the Unanimous Shareholders Agreement. The respondents submit that the Bluebird security is valid because it is not covered by the word “financing” as used in s. 8(b). They submit that the ordinary meaning of the word “financing” means the provision of money for an enterprise and that the words “taken out” do not suggest a prohibition against the advancing of funds. It is their submission that the words “financing” and “taken out” refer to loans made to E.S.J. Equities by third parties and not by Bluebird.

[69] In my view this argument fails. The Unanimous Shareholders Agreement does not restrict 8(b) to apply to third party financing only. The Mortgage and additional security were granted for financing or monies already advanced or to be advanced by Bluebird to E.S.J. Equities.

[70] Neither Joseph Zysko nor ES’J Developments expressly consented to this financing, that is the granting of the Mortgage and the additional security. From the Mortgage and the additional security it is clear that all the parties to the Unanimous Shareholders did not consent. The actions of Eugene and Sally Thorarinson purportedly acting on behalf of E.S.J. Equities in having this Mortgage and additional security granted to Bluebird by E.S.J. Equities was in breach of paragraph 8(b) of the Unanimous Shareholders Agreement. I therefore find that the Mortgage and additional security granted in favour of Bluebird is covered by the word “financing” in

paragraph 8(b) and as all the parties to the Unanimous Shareholders Agreement did not consent to this financing, the Mortgage and the additional security are invalid.

OPPRESSION

[71] The next issue to be decided is was the granting of the Bluebird security oppressive, unfairly prejudicial or does it unfairly disregard the interest of ES'J Developments and Joseph Zysko and is thus in contravention of s. 242 of the **Act**.

> 242(1) A complainant may apply to the Court for an order under this section.
>
> (2) If, on an application under subsection (1), the Court is satisfied that in respect of a corporation or any of its affiliates
>
> > (a) any act or omission of the corporation or any of its affiliates effects a result,
> >
> > (b) the business or affairs of the corporation or any of its affiliates are or have been carried on or conducted in a manner, or
> >
> > (c) the powers of the directors of the corporation or any of its affiliates are or have been exercised in a manner
>
> that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer, the Court may make an order to rectify the matters complained of.

[72] If the granting of the Bluebird security is either oppressive, unfairly prejudicial or unfairly disregards the interests of ES'J Developments or Joseph Zysko pursuant to 242(3) of the **Act** a Court can set aside the Bluebird security. To determine whether the **Act** is oppressive, unfairly prejudicial or unfairly disregards the interests of a shareholder director under s. 242 of the **Act** that facts specific to this case must be considered. As was held by Mr. Justice Rooke in ***218125 Investments Ltd.*** v. ***Patel*** (1995), 33 Alta. L.R. (3d) 245 at 258:

> ... the threshold test for whether ... the powers of the directors have been exercised in a way which is oppressive is one of fairness and ... a broad discretion is conferred on the court to exercise its equitable jurisdiction in determining what is fair in each case.

[73] This threshold test was referred to by Moore, C.J.Q.B. in ***Westfair Foods Ltd.*** v. ***Watt et al.*** (1990), 106 A.R. 40 at 52, para. 54:

> While it is clear that C.B.C.A. s. 241 appears to set out three criteria for determining whether a complainant is entitled to a remedy under that section, it is

> suggested here that the threshold test in each case is one of fairness. Is the impugned conduct or action unfair in regard to the interests of the complainant? If it is not, no relief can be granted pursuant to s. 241. It is apparent however, that the legislation offers virtually no guidelines as to what constitutes unfairness and thereby confers a broad power of discretion upon the court to exercise its equitable jurisdiction in determining what is fair in each particular case.

[74] At p. 51, para. 52 Moore, C.J. referred to cases that attempted to define the key elements of s. 241 wherein oppression was defined as “burdensome, harsh and wrongful” involving “at least an element of the lack of probity or fair dealing to a member in the matter of his proprietary right as a shareholder”. “Unfairly prejudicial” denoted a legislative intent that the Court give to those words “an effect different from and going beyond that given to the word oppressive”. The shorter Oxford Dictionary definition given to prejudicial and unfair is “it is significant that the dictionary definition support the instinctive reactions that what is unjust and inequitable is obviously also unfairly prejudicial”. “Unfair disregard” was defined in ***Stech*** v. ***Davies***, [1987] 5 W.W.R. 563 at 569 by Egbert, J. as “to unjustly or without cause ... pay no attention, ignore or treat as of no importance the interest of the security holders, creditors, directors or officers of a corporation.”

[75] Additionally, in ***Westfair Foods*** **supra**, Moore, C.J. in paragraph 61 states:

> Finally, in considering relief under s. 241 of the **C.B.C.A.** the court may have regard to the following factors in determining whether conduct is unfair: the history and nature of the corporation, the type of interests affected, general commercial practice, the nature of the relationship between the complainant and alleged oppressor, the extent to which the impugned acts or conduct were foreseeable, the expectations of the complainant, the size, structure and nature of the corporation and the detriment to the interest of the complainant.

Moore, C.J. also stated:

> This list, however, is in no way conclusive with respect to those factors which may be considered in determining the applicability of s. 241. Other elements may present themselves depending on the facts of each particular case.

[76] In ***Calmont Leasing Ltd.*** v. ***Kredl et al*** (1994), 142 A.R. 81 at p. 105 para. 130, Russell, J. quoted from the article by Keith A. Ferguson in his paper **The Oppression Remedy: Trends Anyone?** which was prepared for the Legal Education Society of Alberta in 1992 and which counsel in the Calmont Leasing case adopted read:

> ... conduct which will be found to be oppressive, as opposed to unfairly prejudicial or constituting unfair disregard, will involve something amounting to a direct or indirect expropriation, or substantial diminishment, of the value of the complainant's investment in the corporation in question. Frequently the conduct

> of the respondent involves an abuse of position, where the individual moves arbitrarily outside the recognized structure for corporate decision-making.

[77] While Bluebird may have contributed significant funds into financing the Apartment, the role of ES'J Developments was also significant. As per the Unanimous Shareholders Agreement, ES'J Developments managed the construction and development of the Apartment. It was completed to occupancy by September, 2002. This management contribution was not insignificant and was described by Mr. Zysko in his submissions and in the material filed. Mr. Zysko did provide Bluebird with invoices during construction. What was lacking were the itemized invoices for the work done and the material for which the money was spent. Obviously the work in construction was done and materials were provided as the Apartment was erected and occupied and managed by ES'J Developments.

[78] The effect of the Resolution was to completely force Mr. Zysko and ES'J Developments out of their contractual role. The parties who benefited from this action were clearly not Joseph Zysko of ES'J Developments nor E.S.J. Equities but Bluebird and its two Directors, the husband and wife, Eugene and Sally Thorarinson. They effectively, by reason of their majority, were protecting their company's interest to the elimination of Joseph Zysko or ES'J Developments. Through ES'J Developments, Joseph Zysko had an equal interest in E.S.J. Equities to that of Bluebird and its shareholders.

DECISION

[79] In the circumstances specific to this case, the actions of the Directors Sally and Eugene Thorarinson were oppressive, unfairly prejudicial and an unfair disregard for the interests of ES'J Developments, E.S.J. Equities and Joseph Zysko. Therefore, I hold that the Resolution is invalid.

[80] The Mortgage granted in favour of Bluebird, in my view, was done in such a manner that it was firstly contrary to the By-Laws of E.S.J. Equities, secondly contrary to s. 120 of the **Business Corporations Act** and thirdly, contrary and in breach of the Unanimous Shareholders Agreement. In the result, the Mortgage is invalid.

[81] This of course does not end the matter. Even though the Unanimous Shareholders Agreement did not specifically require Bluebird to contribute more than $230,000 in equity financing, Bluebird made a substantial injection of funds into the Project. Bluebird is entitled to recover those additional funds together with the interest earned thereon. Bluebird is not entitled to be reimbursed its $230,000 equity commitment.

[82] The $230,000 equity commitment will be subtracted from the funds injected by Bluebird. The balance of the injected funds and interest thereon will be repaid from the monies which have been paid into Court.

[83] The remaining undistributed balance of funds then remaining in Court will be distributed equally between Bluebird and ES'J Developments.

[84] Bluebird has applied for an order directing the payment out of the full amount of money paid into Court plus interest earned thereon to the Solicitor for Bluebird. I have ordered in paragraph 83 that the remaining undistributed balance of funds plus interest then remaining will be distributed equally between Bluebird and ES'J Developments.

[85] Bluebird also applies that the balance of the proceeds of the sale be paid to Bluebird after payment of any additional legal fees relating to the sale of the Apartment and after payment of the account of Ken Erickson.

[86] On the 31st of January, 2002 Mr. Justice Waite ordered that:

> E.S.J. Equities Inc. shall appoint Ken Erickson, a licensed real estate agent, as an independent third party property to property manage the rental assets of E.S.J. Equities Inc., including the collection of rents, payment of expenses, and all leasing matters pending further order of the court.

No evidence has been tendered as to what, if any, additional legal fees remain unpaid relating to the sale of the property nor has there been any evidence as to whether Ken Erickson's account was or was not paid as there has been no account or accounting filed by Ken Erickson with this Court.

[87] The facts of this case and the affidavit evidence and the submissions of Mr. Zysko do not disclose that ES'J Developments is entitled to a quantum merit award. Nor is there evidence that the project was mismanaged by ES'J Developments or Joseph Zysko. Nor is there evidence that any funds were misappropriated by ES'J Developments and/or Joseph Zysko. In my view, the parties basically performed their contractual roles as described above.

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COSTS

[88] There will be no order with respect to costs at this time. There are a number of previous orders to be addressed before an award of costs can be made. Therefore, costs may be spoken to.

Heard on the 18th day of March, 2003.
Dated at the City of Calgary, Alberta this 7th day of November, 2003

P. Chrumka
J.C.Q.B.A.

Appearances:

Joseph Zysko and ES'J Developments Ltd.
Not Represented by Counsel

Brian E. Silver
for the Respondents

TAB 7

Bill Clause No. 48
CBCA Section No. 120
Topic : Directors and Occiers (Interested Directors' and Officers' contracts)

Sources of Proposed Law

Changes From Present Law

(A) Section 120(1) is amended to cover material contracts or transactions or proposed material contracts or transactions.

(B) Clarifies the timing in par. 120(2)(b) by replacing the word "then" with "at the time of the meeting referred to in paragraph (a)".

(C) Repeal par. 120(5)(a) concerning the interested director's ability to vote on contracts he/she has entered into for the benefit of the corporation.

(D) Amend subs. 120(6) to require that a "material change" in the nature of the interest of a director or officer in a contract or transaction shall be the object of a new declaration.

(E) Permit shareholders to access that part of the directors' meeting minutes, or other documents that disclose interested director or officer contracts or transactions.

(F) Specify that a director or officer is not accountable to the corporation for any profit or gain realized from an interested director or officer contract or transaction so long as the conditions set out in subs. 120(7) are met.

(G) Add a new provision providing for shareholder approval of interested director or officer contracts or transactions as an alternative method of rendering a contract non-voidable notwithstanding non-compliance with the avoidance standards in subs. 120(7), and remove the reference to shareholder approval in subs. 120(7).

(H) Broaden the grounds for a court application in subs. 120(8) to set aside an interested director or officer contract or transaction to include any failure to comply with s. 120 and give the courts the power to make an order directing that the director or officer account to the corporation for any profit or gain realized.

Purpose of Change

(A) Section 120(1): The policy behind s. 120 is to identify those situations in which a director or officer's ability to consider, fairly and effectively, the corporation's interests may be inhibited by self-interest. The addition of the terms "transaction" and "proposed transaction" broadens the coverage of s. 120 and clarifies the extent of the section's application by requiring identification of interests which extend beyond those resulting from material contracts. The additions will also bring the CBCA into line with other Canadian corporate laws.

(B) Par. 120(2)(b): The words "not then interested" do not clearly indicate the timing required for disclosure under the paragraph.

(C) Subsection 120(5): Paragraph 120(5)(a) seems to allow directors to vote on an arrangement for security for money lent to themselves or for obligations undertaken by them which could amount to endorsing a conflict of interest situation. However, the contract must be "for the benefit of the corporation or an affiliate."

S. 120(5)(a) could be interpreted to mean that a director to whom the corporation has lent money will not be precluded from voting on the approval of the arrangement provided the loan is undertaken "for the benefit of the corporation or an affiliate." One of the difficulties with this provision however, is determining when such a loan is made "for the benefit of the corporation" as opposed to for the benefit of the director.

Further, it can be argued that it is unlikely that the approval of a contract that does not offer any benefit to the corporation would withstand the fiduciary duty test set out in s. 122 which requires directors and officers to act with a "view to the best interests of the corporation." Therefore, in accordance with this fiduciary duty, directors should presumably only make loans which benefit the corporation. If all loans benefit the corporation, interested directors would always be entitled to vote on a loan made to them. If a director could always vote what is the necessity of a section which says the director may not vote unless the loan is made for the benefit of the corporation.

Repealing s. 120(5)(a) would disallow interested directors from voting on a contract in which they have a personal interest and therefore are in conflict of interest with the corporation. It would remove the uncertainty around determining whether a contract is in the best interests of the corporation. An interested director shall not vote.

(D) Subsection 120(6): This proposed change would require that the director bring material changes in his/her interest to the attention of the corporation. This information is necessary when a corporation is making decisions about future interested director contracts. The new declaration/information would fairly represent the true nature of the director's interest and would be in line with the fiduciary duties of the director to make disclosure.

(E) Subsection 120(6.1): This proposed change would give shareholders access to information that will help them make fully informed decisions.

(F) Subsection (7): At common law, directors and officers have a fiduciary duty to account to the corporation for any profit they gain from any interested contract or transaction. Furthermore, such contract or transaction would, at common law be void or voidable.

Current s. 120(7) provides that such contract or transaction is neither void nor voidable provided that the director or officer disclosed his interest, the contract or transaction was approved by the directors or shareholders and it was reasonable to the shareholders at the time it was approved. The current wording does not address whether the interested director or officer is accountable to the corporation even where these conditions have been fulfilled.

This amendment would clarify this issue and thereby harmonize the CBCA with other Canadian corporate laws.

(G) Subsection 120(7.1): Subsection 120(7) would provide for director approval and a new subsection would provide for shareholder approval. This change would add flexibility.

(H) Subsection 120(8): This change would clarify that an action may be brought for any breach of this section and would clarify that the courts have the power to order that the director is accountable for any profit. It would also clarify that the effect of a director voting when not allowed is that an action may be brought to void the contract. The CBCA would be brought into line with other Canadian corporate laws.

Similar Provincial Laws
Business Corporations Act (Ontario)
Company Act (British Columbia)
Code civil du Québec
Business Corporations Act (Alberta)
Company Act (New Brunswick)

Current Wording
120. (1) A director or officer of a corporation who

(a) is a party to a material contract or proposed material contract with the corporation, or

(b) is a director or an officer of or has a material interest in any person who is a party to a material contract or proposed material contract with the corporation,

shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his interest.

(2) The disclosure required by subsection (1) shall be made, in the case of a director,

(a) at the meeting at which a proposed contract is first considered;

(b) if the director was not then interested in a proposed contract, at the first meeting after he becomes so interested;

(c) if the director becomes interested after a contract is made, at the first meeting after he becomes so interested; or

(d) if a person who is interested in a contract later becomes a director, at the first meeting after he becomes a director.

(3) The disclosure required by subsection (1) shall be made, in the case of an officer who is not a director,

(a) forthwith after he becomes aware that the contract or proposed contract is to be considered or has been considered at a meeting of directors;

(b) if the officer becomes interested after a contract is made, forthwith after he becomes so interested; or

(c) if a person who is interested in a contract later becomes an officer, forthwith after he becomes an officer.

(4) If a material contract or proposed material contract is one that, in the ordinary course of the corporation's business, would not require approval by the directors or shareholders, a director or officer shall disclose in writing to the corporation or request to have entered in the minutes of meetings of directors the nature and extent of his interest forthwith after the director or officer becomes aware of the contract or proposed contract.

(5) A director referred to in subsection (1) shall not vote on any resolution to approve the contract unless the contract is

(a) an arrangement by way of security for money lent to or obligations undertaken by him for the benefit of the corporation or an affiliate;

(b) one relating primarily to his remuneration as a director, officer, employee or agent of the corporation or an affiliate;

(c) one for indemnity or insurance under section 124; or

(d) one with an affiliate.

(6) For the purposes of this section, a general notice to the directors by a director or officer, declaring that he is a director or officer of or has a material interest in a person and is to be regarded as interested in any contract made with that person, is a sufficient declaration of interest in relation to any contract so made.

(7) A material contract between a corporation and one or more of its directors or officers, or between a corporation and another person of which a director or officer of the corporation is a director or officer or in which he has a material interest, is neither void nor voidable by reason only of that relationship or by reason only that a director with an interest in the contract is present at or is counted to determine the presence of a quorum at a meeting of directors or committee of directors that authorized the contract, if the director or officer disclosed his interest in accordance with subsection (2), (3), (4) or (6), as the case may be, and the contract was approved by the directors or the shareholders and it was reasonable and fair to the corporation at the time it was approved.

(8) Where a director or officer of a corporation fails to disclose his interest in a material contract in accordance with this section, a court may, on the application of the corporation or a shareholder of the corporation, set aside the contract on such terms as it thinks fit.

Proposed Wording

120. (1) A director or **an** officer of a corporation shall disclose to the corporation, in writing or **by requesting** to have **it** entered in the minutes of meetings of directors **or of meetings of committees of directors**, the nature and extent of **any interest that he or she has in** a material contract **or material transaction, whether made or** proposed, with the corporation, **if the director or officer**

(*a*) is a party to **the** contract or **transaction**;

(*b*) is a director or an officer, **or an individual acting in a similar capacity, of** a party to the contract **or transaction; or**

(*c*) has a material interest in **a party to the contract or transaction.**

(2) The disclosure required by subsection (1) shall be made, in the case of a director,

(*a*) at the meeting at which a proposed contract **or transaction** is first considered;

(*b*) if the director was not, **at the time of the meeting referred to in paragraph (*a*)**, interested in a proposed contract **or transaction**, at the first meeting after **he or she becomes** so interested;

(*c*) if the director becomes interested after a contract **or transaction** is made, at the first meeting after **he or she becomes** so interested; or

(*d*) if **an individual** who is interested in a contract **or transaction** later becomes a director, at the first meeting after **he or she becomes** a director.

(3) The disclosure required by subsection (1) shall be made, in the case of an officer who is not a director,

(*a*) **immediately** after **he or she becomes** aware that the contract, **transaction**, proposed contract **or proposed transaction** is to be considered or has been considered at a meeting;

(*b*) if the officer becomes interested after a contract **or transaction** is made, **immediately** after **he or she becomes** so interested; or

(*c*) if **an individual** who is interested in a contract later becomes an officer, **immediately** after **he or she becomes** an officer.

(4) If a material contract or **material transaction, whether entered into or** proposed, is one that, in the ordinary course of the corporation's business, would not require approval by the directors or shareholders, a director or officer shall disclose, in writing to the corporation or **request** to have **it** entered in the minutes of meetings of directors **or of meetings of committees of directors**, the nature and extent of **his or her** interest **immediately** after **he or she** becomes aware of the contract or **transaction**.

(5) A director **required to make a disclosure under** subsection (1) shall not vote on any resolution to approve the contract **or transaction** unless **the contract or transaction**

(*a*) relates primarily to **his or her** remuneration as a director, officer, employee or agent of the corporation or an affiliate;

(*b*) is for indemnity or insurance under section 124; or

(*c*) is with an affiliate.

(6) For the purposes of this section, a general notice to the directors declaring **that a director or an officer** is to be regarded as interested, **for any of the following reasons**,

in **a** contract **or transaction** made with a **party**, is a sufficient declaration of interest in relation to **the** contract **or transaction**:

(*a*) the director or officer is a director or officer, **or acting in a similar capacity, of a party referred to in paragraph (1)(*b*) or (*c*);**

(*b*) the director or officer has a material interest in **the party; or**

(*c*) there has been a material change in the nature of the director's or the officer's interest in the party.

(6.1) The shareholders of the corporation may examine the portions of any minutes of meetings of directors or of committees of directors that contain disclosures under this section, and any other documents that contain those disclosures, during the usual business hours of the corporation.

(7) A contract **or transaction for which disclosure is required under subsection (1) is not invalid, and the director or officer is not accountable to the corporation or its shareholders for any profit realized from the contract or transaction because of the director's or officer's interest in it or**, because the director was present or was counted to determine whether a quorum existed at the meeting of directors or committee of directors that considered the contract **or transaction, if**

(*a*) disclosure of the interest was made in accordance with **subsections (1) to** (6);

(*b*) the directors approved the contract **or transaction; and**

(*c*) the contract or transaction was reasonable and fair to the corporation when it was approved.

(7.1) Even if the conditions of subsection (7) are not met, a director or officer, acting honestly and in good faith, is not accountable to the corporation or to its shareholders for any profit realized from a contract or transaction for which disclosure is required under subsection (1), and the contract or transaction is not invalid by reason only of the interest of the director or officer in the contract or transaction, if

(*a*) the contract or transaction is approved or confirmed by special resolution at a meeting of the shareholders;

(*b*) disclosure of the interest was made to the shareholders in a manner sufficient to indicate its nature before the contract or transaction was approved or confirmed; and

(*c*) the contract or transaction was reasonable and fair to the corporation when it was approved or confirmed.

(8) **If** a director or **an** officer of a corporation fails to **comply** with this section, a court may, on application of the corporation or any of its shareholders, set aside the contract **or transaction** on **any** terms **that** it thinks fit, or **require the director or officer to account to the corporation for any profit or gain realized on it, or do both those things.**

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND DOMENICO SERAFINO AS A PERSON INTERESTED IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF HYDRX FARMS LTD., CANNSCIENCE INNOVATIONS INC. AND SCIENTUS PHARMA INC.

Court File No. CV-21-00659187-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST

Proceeding Commenced at Toronto

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