CITATION: Lemberg v. Perris, 2010 ONSC 3690

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ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

ERIC LEMBERG and VALERIE LEMBERG

Plaintiffs

– and –

MICHAEL GEORGE PERRIS and PERRIS & McINTYRE LLP

Defendants

Richard Campbell, for the Plaintiffs

Deborah Squires, for the Defendants

HEARD: November 23 & 24, 2009, and May 31 & June 1, 2010

REASONS FOR JUDGMENT

GRAY J.

[1] The defendant, Mr. Perris, was the plaintiffs' accountant. He recommended a tax avoidance scheme that was unsuccessful. The plaintiffs were reassessed by the Canada Revenue Agency.

[2] The issue is whether Mr. Perris was a fiduciary, and if so, did he breach his fiduciary duties? If he did, what is the measure of compensation payable to the plaintiffs? If he was not a fiduciary, is he liable in negligence, and if so, what is the measure of the plaintiffs' damages?

Background

[3] The plaintiffs are retired. Before their retirement, they were the sole shareholders of Polymark Manufacturing Inc., a relatively small manufacturer of a polyurethane product.

[4] The defendant, Mr. Perris, is a chartered accountant, and a partner in Perris & McIntyre LLP, the other defendant. Mr. Perris was the accountant for the plaintiffs from 1985 to 2004. He was also the accountant for Polymark.

[5] As an accountant, Mr. Perris performed the normal duties one would expect of an accountant. He prepared the annual financial statements for Polymark, and advised on any financial issues that came up from time to time.

[6] Part of the advice given by Mr. Perris over the years was tax advice. Mr. Perris prepared the tax returns for Polymark, as well as for Mr. and Mrs. Lemberg personally. Mr. Perris advised his clients as to how their financial affairs, and those of the corporation, could be organized in order to minimize taxes. This required a balancing of the income of the corporation with the income of the Lembergs personally, and required consideration of the allocation of their income as salary, bonuses or dividends.

[7] In order to give proper tax advice, Mr. Perris had to become fully familiar with the financial situation of the corporation and the Lembergs. He also had to become familiar with their short and long-term goals, including the eventual sale of the business. Mr. Perris had to advise the Lembergs as to the strategy that they should adopt in order to avoid unnecessary and unwanted taxes that might be incurred upon their retirement. For example, Mr. Perris advised the Lembergs as to what to do about the Cumulative Net Investment Loss ("CNIL") which can have adverse tax consequences if it is allowed to build up and accumulate at the time of a sale of a small business.

[8] Each year, Mr. Perris would discuss with Mr. Lemberg his plans for the upcoming year, and in the longer term. At the same time, Mr. Perris would discuss the financial year-end that was coming to a conclusion, and suggest adjustments in payments for salary, bonuses or dividends that might be appropriate.

[9] From at least 1991, Mr. Perris would send to Polymark an annual "engagement letter", in which the terms of his engagement were outlined and agreed to. The engagement letter was actually in the form of a letter from Polymark to Mr. Perris' accounting firm. Included in the letter was a statement that the client was aware that a company owned by Mr. Perris would earn a commission on any securities sold through that company. Typical of such statements is the following paragraph taken from the letter of engagement, dated April 30, 1997:

> We are aware that Michael G. Perris is also the president and an employee of Mikary Investments Limited, a registered limited market

> dealer. Any securities which he may offer to us and that we may purchase will result in a commission being earned by Mikary Investments Limited. We recognize that this financial service is separate and distinct from your role as a public accountant.

[10] While the engagement letters related to Polymark, it appeared to be recognized that the terms of those letters also applied to services rendered to Mr. and Mrs. Lemberg personally.

[11] Mr. Perris' dealings with the Lembergs and Polymark were almost entirely through Mr. Lemberg. Mr. Perris had very few direct dealings with Mrs. Lemberg. However, there is no dispute that she was a client to the same extent as Polymark and Mr. Lemberg.

[12] Apart from tax advice, Mr. Perris did not act as a financial planner as such for the Lembergs. He did not give advice regarding investments, except to the extent that they were relevant to tax issues. For example, Mr. Perris gave advice in 1989 – 90 regarding investments in a real estate limited partnership, and from 1990 to 1996 in certain film limited partnerships. In those cases, it was anticipated that the investments would have advantageous tax consequences. As it turned out, the real estate investments provided no significant benefit, and the investments in the film limited partnerships had mixed results. While the film limited partnerships provided some immediate tax relief, ultimately there was a capital gain that resulted in some increased tax later.

[13] On one occasion, the Lembergs rejected Mr. Perris's advice that they should buy units in a limited partnership. Indeed, on one of the rare occasions on which Mrs. Lemberg spoke to Mr. Perris, she told him directly that she was not interested.

[14] In 1998 and 1999, Mr. Perris spoke to Mr. Lemberg about the scheme that is the subject of this litigation.

[15] The scheme itself was propounded by AFE Consultants Limited. In essence, limited edition prints would be purchased in bulk and sold to clients at a discount. They would then be donated to various educational institutions in the United States. The client who participated in the scheme, and who purchased a number of prints at a given discounted price, would be given a tax receipt for the purported market value of the prints, which invariably was several times higher than the actual amount paid for the prints. An appraisal was supplied that purported to support the higher appraised value. The client would claim a tax credit based on the appraised value of the prints, rather than the price the client actually paid for them.

[16] Legal opinions were secured from large, well-known Toronto law firms that purported to confirm that tax credits could be obtained based on the higher appraised value of the prints. It should be noted, however, that the opinions were carefully crafted, and subject to a number of conditions. As is usual, the opinions were based on certain assumed facts. For example, it was assumed

that no assurance would be provided to a purchaser of the art that the purchaser would have the opportunity to donate the art to one or more charities. It was assumed that each purchaser would have the opportunity to decide which donees of the art would be most meaningful as a recipient, and that a charity selected would be chosen according to the background and interests of the donor. It was pointed out that if receiving a tax benefit is the sole intention of a purchaser, then there may not be a gift as contemplated in the *Income Tax Act*. In order to qualify as “personal use property” within the meaning of the *Act*, it was recommended that a purchaser actually take delivery of the art, make gifts of some pieces to family members and others, make donations over a period of time to a number of charities, and dispose of the art by way of donation concurrently with the acquisition of additional art for personal use or enjoyment.

[17] In 1998, on the recommendation of Mr. Perris, Mr. Lemberg purchased art through AFE Consultants, and donated it to an American university for a tax credit. In 1999, again on the recommendation of Mr. Perris, both Mr. Lemberg and Mrs. Lemberg made similar purchases and donations for tax credits. The evidence diverges as to the circumstances under which these transactions occurred.

[18] Mr. Lemberg testified that in July, 1998, Mr. Perris attended at his office and recommended that he participate in the scheme. Mr. Lemberg testified that a purchase order for the artwork was already filled in when Mr. Perris attended.

[19] The purchase order, dated July 24, 1998, is on the letterhead of Curated Prints, Ltd. Pursuant to the purchase order, Mr. Lemberg agreed that he wished to purchase works that Thunderbird University had indicated it wished to acquire by way of donations. Mr. Lemberg agreed to purchase 100 works of art at $310 each, for $31,000. He signed the purchase order that day, and provided a cheque in the amount of $31,000, payable to Curated Prints, Ltd.

[20] Mr. Lemberg testified that he and Mr. Perris had a brief discussion about this transaction. He testified that Mr. Perris strongly recommended the transaction. Mr. Lemberg asked why everyone would not do this if it was such an obviously good deal. Mr. Perris told him that one would need a rather large income, of at least $160,000, in order to take full advantage of the program.

[21] Mr. Lemberg testified that the purchase order was entirely filled out by Mr. Perris beforehand, and all he did was sign the form. He said he had never heard of Thunderbird University. He did not question Mr. Perris, except to the limited degree he did, because he assumed that Mr. Perris had done due diligence. In order to get the benefit of the full tax credit, Mr. Lemberg had to increase his bonus, which he did on Mr. Perris’ recommendation.

[22] Ultimately, Mr. Lemberg received a receipt for income tax purposes, dated August 14, 1998, from Thunderbird University, which recorded a donation of 100 limited edition prints having a value of $136,500. He claimed a tax credit in that amount, which was initially accepted by Canada Revenue Agency.

[23] Mr. Lemberg testified that he never saw any of the artwork, nor did he see a catalogue of the artwork. It was never recommended that he frame any of the artwork, or that he accept delivery of any of it. He never heard of Thunderbird University, and it would not have been his intention to benefit Thunderbird University. His only motivation was to get a credit for tax purposes.

[24] Mr. Lemberg participated in the scheme again in 1999. Mr. Perris came to see him in December, 1999, and told him that if he was to participate again, he would have to move fast. Mr. Lemberg asked if Mr. Perris was sure about the scheme, and was assured that there was no problem. Once again, Mr. Lemberg purchased 100 works at $310 apiece, for a total of $31,000. Again, the purchase order had been entirely filled out, and all Mr. Lemberg did was sign it. In this case, the works were being donated to Ferris University. Mr. Lemberg had never heard of Ferris University.

[25] Mrs. Lemberg signed a similar purchase order on December 1, 1999, under which she purchased 50 works of art at $330 apiece, for a total of $16,500. Mr. Lemberg supplied a cheque for $47,500, to cover both purchases. Mrs. Lemberg testified that the form had been filled out before she signed it. She never saw the artwork or a catalogue. She did not take delivery of any of the artwork and did not know where it was delivered. While she ultimately received a tax receipt from Ferris University, she had never heard of Ferris University. The only reason she signed the purchase order was to reduce her tax. She never spoke to Mr. Perris. All her dealings were through her husband.

[26] It should be noted that while Mr. Perris had certain information about the scheme in his possession, none of it was supplied to the Lembergs prior to the commencement of this litigation. This included the legal opinions, some information about Thunderbird University, some information about AFE Consultants, and information about Curated Prints, Ltd.

[27] Mr. Perris, in his evidence, denied that he strongly recommended the scheme to the Lembergs. He asserted that he simply provided options to them, and they made their own decisions. He testified that he had no concerns about the scheme, and he did not think there was any significant risk. Indeed, he invested in the scheme himself. He testified that he had no reason to suspect that the scheme would be investigated by CRA. He said he doubted that he would have said to the Lembergs that there was no risk, although he did not see any reason that it could go sideways.

[28] Mr. Perris acknowledged that, before 1998, the Lembergs' history of charitable giving had been modest. Before 1998, annual charitable donations were generally under $2,000 per year. In 1998, Mr. Lemberg's donation was over $36,000. Mr. Perris acknowledged that the only reason the Lembergs made the donations was to obtain a tax benefit. He did not ask them whether they would have wished to benefit the particular universities, and they did not say that that was their intention. Mr. Perris acknowledged that he did not provide the

Lembergs with the legal opinions or other material that he had obtained before discussing the scheme with them.

[29] In 2001, the Lembergs were reassessed by CRA. Initially, Mr. Lemberg was disallowed the entire amount of the donation in 1998, and for 1999 he was only allowed the actual cost of the donation rather than its higher appraised value. CRA was also going to assess interest and penalties. Mrs. Lemberg was treated the same for 1999.

[30] Ultimately, CRA allowed a credit for the actual cost of the art in both 1998 and 1999, and waived penalties, although interest was charged.

[31] The Lembergs were part of a large number of taxpayers who had similarly invested in the scheme. AFE Consultants took a test case to the Tax Court: see *Klotz v. Canada*, [2004] T.C.J. No. 52 (Tax Court); aff'd [2005] F.C.J. No. 754 (C.A.); leave to appeal refused [2005] S.C.C.A. No. 286. In a lengthy judgment, Bowman A.C.J.T.C. held that the taxpayer could be given a credit for the actual amount paid for the art, but not for the higher appraised value. He also disallowed the penalties that had been assessed by CRA.

[32] In 2006, the Lembergs became suspicious that Mr. Perris had made an undisclosed commission on the artwork. They emailed AFE and asked the amount of the commission paid to Mr. Perris. In response, they were advised: "I am not able to disclose the information concerning the amount of commission paid to Mike Perris."

[33] In his evidence, Mr. Perris confirmed that he had received a "small" amount of money on the transactions. He said it was about $7,500. No confirming documents or other information were produced. He said it was not a commission, but was a fee. He insisted that the Lembergs were aware that he was earning a fee, and he referred to the paragraph in the annual engagement letter that disclosed that Mikary Investments would earn a fee on sales of securities.

[34] Mrs. Lemberg testified that when she discovered that Mr. Perris had earned an undisclosed commission on the transactions, she was very upset. Mr. and Mrs. Lemberg both testified that had they known that Mr. Perris was earning a commission on the transactions, they would not have entered into them.

[35] When the Lembergs were told, in 2001, that they were being reassessed by CRA, Mr. Lemberg called Mr. Perris for his advice. Mr. Perris told him that he should not worry about it, that they should not pay the disputed amounts claimed by CRA, and that it was the intention of the sponsors of the program to fight the issue in court. Mr. Perris advised waiting until the court challenge had been disposed of.

[36] Ultimately, as noted earlier, after the test case in the Tax Court had been disposed of, the Lemberg's were reassessed and allowed credits for the amounts they had actually paid for the artwork, rather than the higher appraised value. They were not assessed penalties, but they were required to pay interest on the underpayments.

[37] Mr. Perris prepared some documents, for the purpose of this litigation, that purport to show what the Lembergs would have paid in tax if they were allowed the entire credit based on the appraised value; if, as was ultimately the case, they were allowed a credit based on what they paid for the artwork; and if they had made no purchase of artwork and/or donation at all.

[38] In the final analysis, the Lembergs paid $78,500 for artwork, which they would not have spent had they not participated in the program. As a result of spending that amount, however, they avoided paying $38,703 in tax. In the result, they were worse off by $39,797 as a result of participating in the program. The parties agree on this calculation.

[39] In addition, however, the Lembergs paid approximately $75,000 in interest on the underpayments. Furthermore, they had to borrow money to pay the back taxes, and they paid approximately $29,000 in interest on the money they borrowed. Accordingly, the total is approximately $144,000, to which they add $7,500 earned by Mr. Perris in secret commissions on the transactions. Thus, the total claim is $151,500.

Submissions

[40] Mr. Campbell, counsel for the plaintiffs, submits that the parties were in a fiduciary relationship. While not a classic fiduciary relationship, such as trustee and beneficiary, or agent or principal, nevertheless, as a result of the confidential relationship built up over the years, it was nevertheless a fiduciary one.

[41] Mr. Campbell points out that the Lembergs trusted Mr. Perris to act in their best interests. He had been their accountant for many years, and he had advised them on how to minimize their taxes, both on an ongoing basis and, prospectively, looking forward to the day they would retire after selling their business. He had become intimately acquainted with all of their financial affairs, and those of their corporation. In the course of giving them tax advice generally, he had made recommendations on investments that were designed to minimize taxes.

[42] While a standard of perfection was not expected for his advice, (and indeed some of Mr. Perris's recommendations regarding limited partnerships were not overly successful), Mr. Perris was expected to at all times act in the Lembergs' best interests rather than his own, apart from the normal fees he would charge for his advice.

[43] In this case, Mr. Campbell submits that Mr. Perris did not act in the Lembergs' best interests. In 1998, he attended on Mr. Lemberg and exerted pressure on him to enter into the transaction. He had in his possession certain information about the scheme, including legal opinions, that he did not disclose to the Lembergs. Even if he did not specifically say there was no risk, as the Lembergs testified, he said nothing that would indicate that there was any significant risk. Indeed, had he examined the legal opinions, he would have

realized that there was indeed a significant risk. Those opinions were based on assumed sets of facts and circumstances that bore little resemblance to the circumstances of the transaction he urged on Mr. Lemberg.

[44] Most significantly, Mr. Perris had a financial interest in the transactions that he did not disclose to the Lembergs. While he called it a fee rather than a commission, Mr. Perris acknowledged that he earned at least $7,500 through the transactions. While he claimed that the paragraph in the annual engagement letter, to the effect that Mikary Investments Limited would earn a commission on sales of securities, constituted disclosure to the Lembergs, it is clear that this is not so. This tax avoidance scheme did not involve the sale of securities; rather, it involved the purchase and donation of artwork, which cannot conceivably be construed as a sale of securities. The Lembergs were adamant that they would not have entered into these transactions had they known Mr. Perris was earning a secret fee or commission, and there is no reason to doubt their evidence in this respect.

[45] Mr. Campbell submits that Mr. Perris breached his fiduciary duties to the Lembergs. He recommended a scheme which he knew, or should have known, was highly risky, but suggested that there was little or no risk. He was motivated, in large measure, because of the financial gain he would make from the transactions, which he did not disclose to the Lembergs.

[46] Mr. Campbell submits that the Lembergs are entitled to be paid equitable compensation as a result of the breach of fiduciary duties by Mr. Perris. He relies in this respect on *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377.

[47] Mr. Campbell submits that the appropriate amount of equitable compensation is the total out-of-pocket loss and expense to which the Lembergs have been put as a result of entering into the transactions. He submits that the net loss, as calculated by Mr. Perris, taking into account the cost of the artwork and the tax actually avoided, is $39,797. To that, he submits, must be added $75,000 paid in interest on the underpayments, plus $29,000 paid on money borrowed to pay the back taxes, and $7,500 in disgorgement of the secret commission. In total, the claim is $151,500.

[48] Mr. Campbell submits that because this is a claim based on a breach of fiduciary duties, it is inappropriate to apply tort concepts such as contributory negligence. In this case, that means it is unnecessary to consider whether the Lembergs could or should have been more diligent before entering into the transactions, such as securing a second opinion rather than relying solely on the advice of Mr. Perris.

[49] In the alternative, if the claim is one that is properly advanced as one of negligence, it would not be proper to conclude that the Lembergs were contributorily negligent. They trusted Mr. Perris, and it was reasonable for them to assume that he had done due diligence before recommending the transactions. If any degree of contributory negligence should be allocated to the Lembergs, it should be minimal, perhaps in the range of 5 to 10%.

[50] Ms. Squires, for the defendants, submits that Mr. Perris was not in a fiduciary relationship with the Lembergs. He was retained as an accountant to provide a defined range of services, which included advising as to appropriate tax saving vehicles. In doing so, he provided options for the Lembergs to consider, which they were free to accept or reject as they saw fit. Indeed, on at least one occasion the Lembergs rejected Mr. Perris's advice, and refused to buy units in a particular limited partnership that he recommended.

[51] Ms. Squires points out that the Lembergs were not unsophisticated neophytes. Mr. Lemberg was an intelligent businessman, who had built up a successful business over the years. He was not ignorant of tax issues, and he was familiar with terminology such as the CNIL. He was well able to sit down with Mr. Perris on an annual basis and intelligently discuss Mr. Perris's recommendations for the current year, and his expectations for the future.

[52] Ms. Squires submits that the Lembergs were perfectly capable of assessing the risk of entering into these transactions, or at least obtaining other advice. It is highly unlikely that a chartered accountant would advise a client that there would be no risk in entering into a transaction of this sort, and Mr. Perris denied that he did so here. A person in the position of the Lembergs would know that it is always possible that the CRA may reassess a taxpayer, and that if the taxpayer is reassessed it would be prudent to pay the disputed tax in order to stop interest accruing. They could have taken steps to minimize their loss, but did not.

[53] With respect to the alleged secret commission, Ms. Squires submits that there was nothing secret about the fee Mr. Perris received. She submits that a reasonable construction of the paragraph in the engagement letters that referred to Mikary Investments should be sufficient to put the plaintiffs on notice that Mr. Perris could earn a fee on any of these transactions, whether they are, strictly speaking, sales of securities. Furthermore, Mr. Perris testified that he advised the Lembergs that he would receive a fee, and his evidence should be accepted.

[54] At best, Ms. Squires submits that the Lembergs' loss is $39,795, as referred to above, and that is the maximum amount to which they should be entitled. However, Ms. Squires submits that there should be deducted from that amount the corporate tax savings that resulted from increased bonuses declared for Mr. and Mrs. Lemberg so that they could take advantage of the scheme. This resulted in a corporate tax saving of $42,120. Therefore, at the end of the day, the Lembergs have actually suffered no loss.

Analysis

[55] The following issues arise for my consideration:

(a) Was Mr. Perris a fiduciary?
(b) If so, did Mr. Perris breach his fiduciary obligations?

(c) If Mr. Perris breached his fiduciary obligations, what compensation must be paid to the Lembergs?
(d) If Mr. Perris was not a fiduciary, is he liable in negligence?
(e) If Mr. Perris is liable in negligence, were the Lembergs contributorily negligent?
(f) If the case sounds in negligence, what damages are payable?

[56] In the final analysis, it will be unnecessary for me to address issues (d), (e) and (f) because I have concluded that the case can be decided by addressing the first three issues. I will address those issues in turn.

(a) Was Mr. Perris a fiduciary?

[57] Fiduciary obligations can arise as a matter of course in certain well-understood relationships, such as trustee and beneficiary, or principal and agent. However, it is clear from *Hodgkinson v. Simms*, *supra*, that fiduciary obligations can also arise in a myriad of other circumstances, depending on the particular nature of the relationship in question. In that particular case, the Supreme Court of Canada held that an accountant had fiduciary obligations arising out of his relationship with a stockbroker, who was inexperienced in tax planning, and who wanted an independent professional to advise him respecting his tax planning and tax sheltering needs. He relied heavily on the accountant's advice on tax matters, and the relationship was such that he did not really question the accountant about the reasons underlying the advice given. The accountant advised the broker to invest in real estate investment projects, and he lost heavily when the value of the investments declined.
[58] It turned out that the accountant was acting for the developers during the relevant period, and he did not disclose this. The broker would not have invested in the impugned projects had he known the true nature and extent of the accountant's relationship with the developers.
[59] La Forest J., with whom L'Heureux-Dubé and Gonthier JJ. concurred, held that there was a fiduciary relationship between the broker and the accountant, and that the accountant had breached his fiduciary obligations. In a concurring judgment, Iacobucci J. agreed with La Forest J. on the existence of a fiduciary duty between the parties, and the existence of a breach of duty through the accountant's non-disclosure of the pecuniary interest with the developers. Sopinka J., McLachlin J. (as she then was) and Major J. dissented.
[60] At p. 408, La Forest J. noted with approval the dissenting reasons of Wilson J. in *Frame v. Smith*, [1987] 2 S.C.R. 99, at p. 136, who proposed a three-step analysis to guide the courts in identifying new fiduciary relationships:

> She [Wilson J.] stated that relationships in which a fiduciary obligation has been imposed are marked by the following three

> characteristics: (1) scope for the exercise of some discretion or power; (2) that power or discretion can be exercised unilaterally so as to effect the beneficiary's legal or practical interests; and (3) a peculiar vulnerability to the exercise of that discretion or power.

[61]   At p. 409, La Forest J. stated as follows:

> As I noted in *Lac Minerals*, however, the three-step analysis proposed by Wilson J. encounters difficulties in identifying relationships described by a slightly different use of the term "fiduciary", vis situations in which fiduciary obligations, though not innate to a given relationship, arise as a matter of fact out of the specific circumstances of that particular relationship; see at p. 648. <u>In these cases, the question to ask is whether, given all the surrounding circumstances, one party could reasonably have expected that the other party would act in the former's best interests with respect to the subject matter at issue. Discretion, influence, vulnerability and trust were mentioned as non-exhaustive examples of evidential factors to be considered in making this determination.</u>   [Emphasis added]

[62]   On the same page, La Forest J. continued by stating: "Thus, outside the established categories, what is required is evidence of a mutual understanding that one party has relinquished its own self-interest and agreed to act solely on behalf of the other party."

[63]   At p. 423, La Forest J. stated that in many advisory relationships norms of loyalty and good faith are often indicated by codes of professional responsibility and behaviour set out by the relevant self-regulatory body.

[64]   On the facts of this case, I have no hesitation in concluding that, in relation to matters of tax planning, Mr. Perris had undertaken to act solely on behalf of the Lembergs and had relinquished his own self-interest in that regard, except for the normal fees he would charge for providing his advice.

[65]   The parties had developed a relationship of mutual trust and confidence over a number of years. Mr. Perris had become fully familiar with the financial affairs of his clients, and his tax advice was given with the sole objective of improving their tax position, both in the short and long term. The Lembergs were entitled to assume that any advice given to them regarding tax matters would be advice honestly given by Mr. Perris with a view to advancing their interests, and not those of Mr. Perris. As was the case in *Hodgkinson*, the elements of discretion, influence, vulnerability and trust were present.

[66]   For the foregoing reasons, I conclude that Mr. Perris was in a fiduciary relationship with the Lembergs.

(b) If Mr. Perris was a fiduciary, did he breach his fiduciary obligations?

[67] Based on the evidence as a whole, I have no doubt that Mr. Perris breached his fiduciary obligations.

[68] The most fundamental way in which Mr. Perris breached his fiduciary obligations was by obtaining a secret commission. I accept the evidence of the Lembergs that the fee or commission earned by Mr. Perris was not disclosed to them.

[69] Article 2.07 of the *Rules of Professional Conduct of the Institute of Chartered Accountants of Ontario* provides as follows:

> 2.07 **Unauthorized benefits**
>
> A member or student shall not, in connection with any transaction involving a client or an employer, and a firm shall not, in connection with any transaction involving a client, hold, receive, bargain for, become entitled to or acquire, directly or indirectly, any fee, remuneration or benefit for personal advantage or for the advantage of a third party without the knowledge and consent of the client or employer, as the case may be.

[70] Mr. Perris undoubtedly knew that he was required to disclose any commission or fee earned through a transaction involving a client, over and above his normal professional fees. That is why, in my view, the paragraph in the annual engagement letters was included. In that paragraph, Mr. Perris disclosed that his company, Mikary Investments, would earn a fee on sales of securities.

[71] Clearly, in my view, the paragraph in the annual engagement letters is not sufficient to qualify as disclosure of the secret commissions here. First of all, these transactions did not involve sales of securities. By no stretch of the imagination can they be construed to be so.

[72] Second, the secret commission here was paid by the proponent of the scheme, not by the Lembergs. That means that in fact, Mr. Perris was working for the proponent of the scheme. The commission meant that Mr. Perris had a financial interest in the transaction that was at odds with the interests of the Lembergs. The Lembergs were entitled to independent, unvarnished advice as to whether the transactions were in their best interests. Instead, unbeknownst to them, the transactions were in the interests of Mr. Perris, who earned an undisclosed fee or commission.

[73] The fact that Mr. Perris had a financial interest in the transactions goes some way, in my view, to explaining the rest of his conduct. Mr. Perris paid scant attention to warning signs that should have alerted him to the risk his clients were

undertaking. The legal opinions, which lent apparent legitimacy to the scheme, were carefully crafted and laid out assumed sets of facts that bore little resemblance to the circumstances of the actual transactions that were recommended. Mr. Perris made no attempt to apprise the Lembergs of the information he had in his possession about the scheme, including the legal opinions themselves. I accept the evidence of Mr. Lemberg that Mr. Perris exerted considerable pressure on him to participate. The relevant purchase orders were filled out before Mr. Perris even arrived. The purchase orders were in Mr. Perris's handwriting. In 1999, Mr. Perris advised that Mr. Lemberg should act quickly, as time was running out.

[74] The Lembergs were vulnerable, in the sense that they trusted Mr. Perris's integrity, and the independence of his advice. They assumed he had done the requisite degree of due diligence, so that they would not have to do so themselves. They assumed that any appreciable risk would be disclosed to them. They relied on his advice and his integrity. As it happened, their trust was misplaced. His advice was not independent; he had a financial interest in the transaction, which he did not disclose. He either did insufficient due diligence, or if he did, he paid it no heed. His recommendations were accompanied by pressure and haste, and little, if any, time for reflection by his clients. His integrity was impaired by self-interest.

[75] For the foregoing reasons, I conclude that Mr. Perris breached his fiduciary obligations to the Lembergs.

(c) If Mr. Perris breached his fiduciary obligations, what compensation must be paid to the Lembergs?

[76] The Lembergs claim equitable compensation for breach of Mr. Perris's fiduciary obligations. The concept of equitable compensation is difficult to articulate and apply. The purpose of equitable compensation is restitutionary: that is, it is intended to put the plaintiff in as good a position as he or she would have been in had the breach of fiduciary obligation not occurred.

[77] While the calculation of equitable compensation may approximate, in some cases, the calculation of damages for breach of contract or negligence, that will not necessarily be the case. In a case such as this, where negligence is the alternative cause of action, there is an issue as to whether concepts such as mitigation or contributory negligence, that may reduce the amount payable by the defendant, have any application to equitable compensation.

[78] The issue is of some importance in this case. If this case were one of negligence, there is a serious issue as to whether there was contributory negligence on the part of the plaintiffs, and if so, how much their recovery should be reduced. It can be strongly argued (and indeed it was so argued here) that prudent investors in the position of the plaintiffs should have seriously asked themselves whether the proposed scheme was too good to be true, and whether,

at the very least, they should have sought a second opinion. Thus, it is necessary to consider, with some care, whether the concept of contributory negligence applies to a claim for breach of fiduciary duty, either directly or by analogy, and if it does, whether it should be applied here.

[79] At p. 440 of *Hodgkinson, supra*, La Forest J. referred to the restitutionary principle in the case of a breach of a fiduciary duty, but framed the discussion in terms of damages. However, he rejected an argument that the Court should conclude that the plaintiff's loss was not caused by any default of the defendant, but rather was caused by the decline in the real estate market. La Forest J. held that, as a fiduciary, the defendant was not entitled to rely on such considerations. Having breached his fiduciary obligations, the defendant was required to make good the plaintiff's loss, regardless of whether the loss may have been caused in any event by market forces.

[80] La Forest J. referred to, and distinguished, the Court's earlier decision in *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534. In that case, the plaintiffs had suffered loss as a result of a failed warehouse development, which failed because a warehouse could not be constructed as a result of some inability to drive piles into soils on which the warehouse was to be built. As it developed, the solicitors for the plaintiffs had made a secret profit from the original transaction, and the plaintiffs sued them for breach of their fiduciary duty. The Court unanimously held that the plaintiff was entitled to equitable compensation. While the judges agreed on the result, upholding the obligation of the solicitor to make good the loss of the plaintiff, the Court divided on the question of whether the plaintiff's claim for equitable compensation could be reduced if it were found that actions of the plaintiff had exacerbated the loss.

[81] Wilson J. took no part in the judgment, so the case was ultimately decided by eight judges. La Forest J. delivered judgment on behalf of himself, Sopinka, Gonthier and Cory JJ. McLachlin J., (as she then was), delivered judgment on behalf of herself, Lamer C.J.C. and L'Heureux-Dubé J. Stevenson J. delivered a separate concurring judgment.

[82] McLachlin J. held that the purpose of equitable compensation is restitution and, generally speaking, concepts such as mitigation and contributory negligence are not relevant. However, she held that common law principles of that sort may be applied by analogy in considering what is equitable. At para. 23, after considering a number of authorities, she stated that: "The thrust of these dicta is that while the plaintiff will not be required to act in as reasonable and prudent a manner as might be required in negligence or contract, losses stemming from the plaintiff's unreasonable actions will be barred." In the same paragraph she stated that:

> This approach to mitigation accords with the basic rule of equitable compensation that the injured party will be reimbursed for all losses flowing directly from the breach. When the plaintiff, after

> due notice and opportunity, fails to take the most obvious steps to alleviate his or her losses, then we might rightly say that the plaintiff has been "the author of his own misfortune". At this point the plaintiff's failure to mitigate may become so egregious that it is no longer sensible to say that the losses which followed were caused by the fiduciary's breach. But until that point mitigation will not be required.

[83] La Forest J. went somewhat further, holding that there was no reason in principle why concepts such as contributory negligence should not be applied in determining the quantum of equitable compensation. In this respect, he cited with approval the decision of the New Zealand Court of Appeal in *Day v. Mead*, [1987] 2 N.Z.L.R. 443 (C.A.). In particular, he quoted the judgment of Cooke P., at p. 451:

> Whether or not there are reported cases in which compensation for breach of a fiduciary obligation has been assessed on the footing that the plaintiff should accept some share of the responsibility, there appears to be no solid reason for denying jurisdiction to follow that obviously just course, especially now that law and equity have mingled or are interacting. It is an opportunity for equity to show that it has not petrified and to live up to the spirit of its maxims. Moreover, assuming that the *Contributory Negligence Act* does not itself apply, it is nevertheless helpful as an analogy, on the principle to which we in New Zealand are increasingly giving weight that the evolution of judge-made law may be influenced by the ideas of the legislature as reflected in contemporary statutes and by other current trends.

[84] At para. 83, La Forest stated:

> I agree with this approach. As I have attempted to demonstrate, it would be possible to reach this result following a purely equitable path. I agree with Cooke P. that the maxims of equity can be flexibly adapted to serve the ends of justice as perceived in our days. They are not rules that must be rigorously applied but malleable principles intended to serve the ends of fairness and justice.

[85] In his brief judgment, Stevenson J. stated that he did not agree that principles of contributory negligence were introduced into equity by fusion. At para. 96, he stated that "I do not say that a court of equity might not find some

losses to be caused by a plaintiff rather than a defendant, and to be too remote in that sense, but it would not do so because of the fusion of law and equity."

[86] Textbook writers have been somewhat inconsistent in their articulation of the relevant principles. For example, in Rotman, *Fiduciary Law* (Thomson Carswell, 2005), at p. 643, the author states that "Although, ..., there are significant problems associated with unreflectively imposing common law causality to breach of fiduciary duty claims, the application of the concepts of mitigation and contributory negligence to claims of fiduciary duty is particularly illustrative of the inappropriateness of importing common law considerations to equitable causes of action", and in the same paragraph he states that "For these reasons, mitigation and contributory negligence are, for the most part, inapplicable to claims of breach of fiduciary duty." The author refers, as authority, to *Pilmer v. Duke Group Ltd.* (2001), 207 C.L.R. 165 (Australia H.C.). At para. 86 of the judgment of the majority in that case, it is stated that "it is sufficient to say that the decision in *Astley v. Autrust Ltd.* (1999), 197 C.L.R. 1., indicates the severe conceptual difficulties in the path of acceptance of notions of contributory negligence as applicable to diminish awards of equitable compensation for breach of fiduciary duty." In the same paragraph, the majority stated:

> Contributory negligence focuses on the conduct of the plaintiff, fiduciary law upon the obligation by the defendant to act in the interests of the plaintiff. Moreover, any question of apportionment with respect to contributory negligence arises from legislation, not the common law. *Astley* indicates that the particular apportionment legislation of South Australia which was there in question did not touch contractual liability. The reasoning in *Astley* would suggest, *a fortiori*, that such legislation did not touch the fiduciary relationship.

[87] In contrast, Michael Ng in *Fiduciary Duties* (Canada Law Book, 2007) (loose leaf edition), at sec. 13:20.10.20, states that "Losses will, however, be limited by other factors, such as the lack of any causal link between a breach and a loss, and any negligence of the claimant." For this proposition, the author cites the judgment of the Supreme Court of Canada in *Canson, supra*. With respect, for the reasons articulated earlier, I do not think that proposition flows inexorably from the various judgments of the Court in *Canson*.

[88] I think it is possible to summarize the appropriate principle as follows. While it may not be appropriate to directly apply the concept of contributory negligence to the calculation of losses flowing from a breach of fiduciary duty, as stated by Cooke P. in *Day v. Mead*, and as adopted by La Forest J. in *Canson*, it may be appropriate to apply the concept by analogy where it is equitable to do so. That is how I read the judgment of McLachlin J. in *Canson*. At the end of the

day, the question is whether it is equitable, in the particular circumstances of the case, to reduce the recovery of the plaintiff because he or she failed to take some reasonable step that might have reduced or eliminated the loss.

[89] In my view, if the question is put this way the answer in this case is clearly no. In hindsight, one can easily say that the plaintiffs should have been more suspicious of these transactions. Indeed, it seems that Mr. Lemberg was, in fact, somewhat suspicious. He asked why everyone would not enter into this sort of transaction if it is such a good deal. He did not take the next step of securing a second opinion.

[90] In the final analysis, I do not think second guessing of the plaintiffs' action or inaction in this way is productive. The Lembergs relied on Mr. Perris, and assumed that he had done his due diligence. They trusted Mr. Perris, and if he said the transaction was something they should enter into, they assumed it was all right. In the end, I do not think the plaintiffs' compensation should be reduced because, in 20/20 hindsight, the plaintiffs might have ignored Mr. Perris's advice and done something different.

[91] For the foregoing reasons, Mr. Perris must compensate the Lembergs for all of their losses. The question is what those losses are.

[92] The parties are agreed that the basic loss is $39,795. To that must be added disgorgement of the secret commission of $7,500.

[93] I do not agree that the Lembergs' losses include the interest that they paid CRA for the underpayments, nor do they include interest on the money they borrowed to pay what was owing. The Lembergs had the use of the money until they were required to repay it, and I have no evidence that the interest rate charged by CRA was higher than prevailing interest rates that the Lembergs could have received had they invested the money. Furthermore, I have no evidence that the Lembergs could not have paid the amounts required out of their own resources, rather than borrowing the money. Interest as damages is not appropriate in these circumstances.

[94] I do not agree with Ms. Squires, however, that the defendants should be given credit for any corporate tax savings as a result of increased bonuses for the Lembergs. It is undoubtedly possible, and indeed probable, that the Lembergs paid higher personal taxes as a result of the bonuses that were declared. It is quite possible that if this scheme had not been entered into, the bonuses would not have been declared. I have no evidence as to the potential tax consequences if that had been done. In the final analysis, it is entirely too speculative as to what may or may not have happened if the bonuses had not been declared, and I simply do not think it is equitable to reduce the compensation to the plaintiffs on account of these considerations.

Disposition

[95] For the foregoing reasons, the plaintiffs shall have judgment in the amount of $45,295, together with pre-judgment interest. Pre-judgment interest shall run at the statutory rate from the date of issuance of the statement of claim to the date of judgment. If there is any dispute about the calculation, I may be spoken to.

[96] I will entertain written submissions with respect to costs, not to exceed three pages, together with a bill of costs. I can also be advised of any offers to settle or any other circumstances that may affect the exercise of my discretion. Mr. Campbell shall have ten days to file his submissions, and Ms. Squires shall have ten days to respond. Mr. Campbell shall have five days to reply.

GRAY J.

Released: June 30, 2010

CITATION: Lemberg v. Perris, 2010 ONSC 3690

COURT FILE NO.: 682/07

DATE: 2010-06-28

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

ERIC LEMBERG and VALERIE LEMBERG

Plaintiffs

– and –

MICHAEL GEORGE PERRIS and PERRIS & McINTYRE LLP

Defendants

REASONS FOR JUDGMENT

Gray J.

Released: June 30, 2010