

ARBITRATION

B E T W E E N:

[REDACTED]

Claimant

and

[REDACTED]

Respondents

DECISION AND REASONS

Date of Hearing: Tuesday, [REDACTED] and Wednesday, [REDACTED]

Place of Hearing: ADR Chambers, 180 Duncan Mill Road,
4th Floor, Toronto Canada

Appearances:

For the Claimant: [REDACTED]

For the Respondents: [REDACTED]

Arbitrator: Allan J. Stitt, ADR Chambers

Introduction

This is an unusual case in the sense that the Respondent admits that it had a contractual obligation, did not perform its obligation, and misrepresented to the Claimant that it had, in fact, performed its obligation. The issue I have to determine relates only to damages, and, specifically, the extent to which any inaction of the Claimant after the breach of contract (and misrepresentation) should eliminate or reduce the damages that would have otherwise been payable.

The claims against [REDACTED] have been abandoned. The claims for special and consequential damages have also been abandoned.

Facts

The following facts are not in dispute:

Pursuant to an asset purchase agreement dated [REDACTED] (the "Purchase Agreement"), the Respondent [REDACTED] purchased all of the assets of the Claimant [REDACTED]. [REDACTED] the President of [REDACTED], entered into an employment agreement with [REDACTED] on closing, as did his wife, [REDACTED] and another employee of [REDACTED]. [REDACTED] employment with [REDACTED] was terminated four weeks after she started.

As part of its compensation pursuant to the Purchase Agreement, [REDACTED] received [REDACTED] units ("[REDACTED] Units") and was a party to the [REDACTED] (the "[REDACTED]"). [REDACTED] received quarterly capital distributions of [REDACTED] with respect to the [REDACTED].

There is a dispute with respect to whether [REDACTED] received all that it was entitled to from the Purchase Agreement and that dispute is subject to a separate arbitration to be held at a future date.

As another part of its compensation pursuant to the Purchase Agreement, [REDACTED] received [REDACTED] Class B Limited Partnership Units of [REDACTED] ("[REDACTED] Units").

[REDACTED] and [REDACTED] employment was terminated on [REDACTED]. [REDACTED] commenced litigation against [REDACTED] with respect to the termination of his employment.

Pursuant to the [REDACTED] Agreement, when [REDACTED] employment was terminated, [REDACTED] was required to make an election either to sell its [REDACTED] Units immediately and have the proceeds of sale held in escrow for two years, or to have the [REDACTED] units held in escrow, and either sell them during the two year period or thereafter.

On [REDACTED], [REDACTED] advised [REDACTED] that [REDACTED] elected to sell the [REDACTED] Units with the effective date of sale being the date of termination.

On [REDACTED], [REDACTED] General Counsel, [REDACTED] wrote to [REDACTED] counsel (the "[REDACTED] Letter") advising that:

- (a) The notice from [REDACTED] dated [REDACTED] served as sufficient notice to the Management Committee of [REDACTED], pursuant to the [REDACTED] Agreement;

- (b) The [REDACTED] Units had been sold as of [REDACTED];
- (c) The valuation date for the [REDACTED] Units had been determined to be [REDACTED], the date of [REDACTED] termination from [REDACTED];
- (d) The value of the [REDACTED] Units had been determined to be [REDACTED] per unit; and
- (e) The proceeds from the sale of the [REDACTED] Units ([REDACTED]) would be held in escrow by [REDACTED] for the duration of the two year non-competition period under the [REDACTED] Agreement and would be paid to [REDACTED] in full, along with any accrued interest, within 10 business days of the end of the non-competition period ([REDACTED]).

On [REDACTED], [REDACTED] advised [REDACTED] that it disagreed with the \$ [REDACTED] unit value attributed by [REDACTED], and claimed that the proper unit value was \$ [REDACTED] per unit, the trading price of the [REDACTED] units on [REDACTED].

Notwithstanding the content of the [REDACTED] Letter, [REDACTED] had not sold the [REDACTED] Units and in fact never sold the [REDACTED] Units.

After [REDACTED] termination of employment, [REDACTED] continued to receive payments relating to its holding of the [REDACTED] Units. In addition, [REDACTED] continued to receive quarterly payments from [REDACTED] of \$ [REDACTED]. The cheques for both were delivered to [REDACTED] without cover letters.

On [REDACTED], [REDACTED] was converted into a corporation. Thereafter, the quarterly payments of \$ [REDACTED] were dividends rather than capital distributions.

In [REDACTED] and [REDACTED], [REDACTED] made inquiries about the funds that, according to the [REDACTED] Letter, were held in escrow for [REDACTED].

On [REDACTED], [REDACTED] advised [REDACTED] for the first time that the [REDACTED] Units had not been sold in [REDACTED] and that [REDACTED] intended to deliver to [REDACTED] a share certificate instead of the sale proceeds.

On [REDACTED], [REDACTED] delivered the [REDACTED] Units to [REDACTED]. [REDACTED] immediately sold the [REDACTED] Units for total net proceeds of \$ [REDACTED]. [REDACTED] claims that damages should flow from [REDACTED] breach of contract and that it should be entitled to damages to put it in the same position it would have been in if the [REDACTED] Units had been sold on [REDACTED].

Jurisdiction

Section [REDACTED] of the Purchase Agreement provides that the resolution of all disputes (with some exceptions that are not relevant for our purposes) shall be determined by arbitration and that the arbitration shall be conducted by a single arbitrator to be appointed by agreement of the disputing parties. By Terms of Appointment dated [REDACTED], the parties to this dispute agreed that I would be appointed as the arbitrator to determine the issues presented to me in this arbitration.

Issues

The main issue I must determine is, to what extent should the actions by the employees of [REDACTED] reduce or eliminate the amount that would otherwise have been owing from [REDACTED] to [REDACTED] as damages for breach of the Purchase Agreement and the misrepresentation.

If I find that damages are owing to [REDACTED], I must then determine the appropriate [REDACTED] [REDACTED] unit price to apply.

Finally, I must determine whether the payment to those who were unitholders as at [REDACTED] should have been paid to [REDACTED].

Evidence and Arguments

This case was presented in an unusual order. Because there was an admitted breach of the Purchase Agreement by [REDACTED] and an admitted misrepresentation, and the issues I was asked to determine related to the actions of [REDACTED], the Respondent ([REDACTED]) presented its case first, and [REDACTED] responded, in effect, to the case set out by [REDACTED].

The Respondent's Witnesses

The first witness for the Respondent was [REDACTED] Executive Vice-President of [REDACTED].

[REDACTED] testified that the normal process at [REDACTED] if a small number of [REDACTED] units were to be sold, was that the units were offered internally to [REDACTED] staff and the price paid by staff was the average over the prior 30 days.

With respect to the [REDACTED] Units held by [REDACTED], the number of units was high enough that in order to purchase the units, shares of [REDACTED] would have to be sold into the market to raise the money to buy the [REDACTED] Units. The price for the shares would have been the market price. [REDACTED] view was that if enough shares to purchase the [REDACTED] [REDACTED] Units were sold into the market, the price of the shares would likely have been affected (and dropped) since the supply of shares would have exceeded the demand.

[REDACTED] knew that [REDACTED] Units were held in escrow and not sold. He had no personal knowledge of the [REDACTED] Letter until about [REDACTED]. Prior to that time, the only people in [REDACTED] who were aware of the content of the [REDACTED] Letter were [REDACTED] and her paralegal, [REDACTED]. When [REDACTED] learned of the existence of the [REDACTED] Letter, he knew he "had a problem". He met with [REDACTED] CFO and then General Counsel (who had replaced [REDACTED]) and collectively, they decided not to inform [REDACTED] of the error that [REDACTED] had made. In their view, [REDACTED] "clearly already knew" that the [REDACTED] Units were not sold because [REDACTED] had continued to receive cheques in relation to those [REDACTED] Units.

[REDACTED] testified that [REDACTED] would have received a letter from the [REDACTED] accountants, [REDACTED], to "Unitholders of [REDACTED]" and would have received notice of the [REDACTED] Annual General Meeting.

█ next witness was █, an Assistant Corporate Secretary and paralegal at █ who had worked with █.

█ testified that he saw a copy of the █ Letter when it was sent. He therefore knew that █ had been informed that the █ Units had been sold. He also had access to the list of unitholders at █ and could have looked at the list to determine whether the shares had, in fact, been sold, had he chosen to do so.

The Respondent's final witness was █, a Senior Manager at █ accounting firm, █. He testified that he put together the list of unitholders based on information given to him by █ and █.

The Claimant's Witnesses

█ first witness was █. She worked at █ (and its predecessor) with her husband, █. She was responsible for human resources and other non-monetary issues with respect to █.

She testified that when she and █ were fired, █ decided to sell the █ Units because she and █ were worried about the future value of the █ Units. She received a copy of the █ Letter in █ and assumed the █ Units had been sold.

When █ continued to receive cheques relating to the █ Units, █ brought to the attention of █ and █ that █ continued to receive payments that must have related to the █ Units. The three of them met to talk about it since they did not know what the payments were for. They concluded that the payments related to the fact that the money that █ received for the sale of the █ Units was being held in escrow, and that these payments related to that money. Since other █ unitholders continued to receive payments, █, █ and █ assumed that █ determined that █ should not be in a different position than other unitholders because █ possessed neither the █ Units (which █ understood had been sold) nor the proceeds from the sale of the █ Units (which █ understood were being held in escrow). █ knew that the █ Letter stated that interest on the money paid in escrow would be paid to █ at the end of the escrow period, but concluded that █ would not have continued to have made these quarterly payments to █ if █ believed that it did not owe the money to █.

█ said that she considered the payments to be "interest". She said that, looking back, perhaps she should have questioned why █ received the money, but she did not question it at the time.

█ did not learn that the █ Units had not been sold until early in █. When she did learn that they were not sold, she was shocked.

The next witness for █ was █. █ worked with █ and █ in their companies until █. She received the mail and deposited cheques, among other tasks.

After [REDACTED], when [REDACTED] received the cheques relating to the [REDACTED] Units, she didn't know what they were for and recalled the meeting with [REDACTED] and [REDACTED] to talk about the issue. Like [REDACTED], [REDACTED] assumed that the payments were compensation for [REDACTED] holding the funds relating to the [REDACTED] Units. She knew the money was not interest but thought it was dividends or other compensation. She assumed that [REDACTED] knew what they were doing.

The next witness called by [REDACTED] was [REDACTED]. He testified that he also recalled the meeting with [REDACTED] and [REDACTED] to talk about the cheques received in relation to the [REDACTED] Units after the termination of [REDACTED] employment by [REDACTED]. [REDACTED] thought that the money was compensation "at the same level as before" because [REDACTED] possessed neither the [REDACTED] Units nor the money from their sale. He didn't care about why [REDACTED] thought the money was owing to [REDACTED]. He assumed that [REDACTED] made its decision to send the money to [REDACTED] consciously.

He testified that when he learned in [REDACTED] that the [REDACTED] Units had not been sold, he was on a ladder and almost fell off because he was so stunned and surprised.

The final witness for [REDACTED] was [REDACTED], the accountant for [REDACTED]. He confirmed that [REDACTED] year end was [REDACTED] and that he received from [REDACTED] the information necessary for him to prepare financial statements almost six months later. Therefore, for the fiscal year that started [REDACTED] and ended [REDACTED], he received material just prior to the end of [REDACTED].

Analysis

I want to start my analysis by considering what actual knowledge [REDACTED], the company, had throughout the relevant period. The evidence is clear that [REDACTED], [REDACTED] General Counsel, had actual knowledge that [REDACTED] had requested that the [REDACTED] Units be sold as of [REDACTED], and that [REDACTED] had been advised by [REDACTED] that [REDACTED] had sold the [REDACTED] Units on [REDACTED]. [REDACTED] had actual knowledge that the [REDACTED] Units were not sold on [REDACTED] and, in fact, were never sold by [REDACTED].

[REDACTED] testified that he did not personally have actual knowledge until [REDACTED] that [REDACTED] had requested that the [REDACTED] Units be sold as at [REDACTED], and that [REDACTED] had told [REDACTED] that the [REDACTED] Units had been sold when in fact they had not. [REDACTED] argued that it was only in [REDACTED], therefore, that a single person at [REDACTED] had knowledge of both events.

This argument misses the point. [REDACTED] had knowledge of all of the events. The General Counsel, [REDACTED], knew that [REDACTED] had elected to sell the [REDACTED] Units in [REDACTED] and that the [REDACTED] Letter had been sent to [REDACTED]. The Executive Vice-President, [REDACTED], knew that the [REDACTED] Units were not sold, as he testified. Therefore, [REDACTED], the company, had actual knowledge of both facts.

It is clear that the communication structure at █████ was such that █████ and █████ did not communicate with each other about correspondence received from █████ (such as the letter from █████ to █████ stating that █████ elected to sell its █████ Units as of █████, █████), the representations made by █████ to █████ (such as those in the █████ Letter) and the content of █████' list of █████ unitholders. █████ cannot hide behind its flawed communication structure, however, as a reason to put the onus on someone outside the company to inform it of information that █████ already knew (and, of course, ought to have known).

█████ had an obligation to structure itself and put in place processes so that it did not breach its contractual obligations when, for example █████ elected to sell the █████ Units triggering █████ contractual obligation to sell those Units. █████ also had an obligation to structure itself so as to inform unitholders that its units had been sold only when those units had, in fact, been sold. It also had an obligation to ensure that its correspondence confirming the sale of the units was consistent with the facts in its registry of unitholders. In other words, █████ should have structured itself so that █████ and █████ communicated with each other to make sure that █████ fulfilled its contractual obligations to sell the █████ Units when requested to do so, and to make sure that the company's list of unitholders was consistent with correspondence sent to █████ making representations about ownership of █████ Units.

█████ cannot be in a better position by structuring itself to *not* have proper internal communication channels than it would have been if █████ had been properly structured so that the General Counsel and the Executive Vice-President communicated with each other about these issues as appropriate. I must treat █████ the same way I would have if one individual at █████ knew, at all times, that █████ had requested that the █████ Units be sold, and that █████ had been informed that the █████ Units had been sold when, in fact, they had not been sold. To do otherwise would be to reward █████ for having a flawed internal communication structure.

Even if I am incorrect in finding corporate knowledge, there was one person, a senior executive at █████, who knew or ought to have known that █████ had requested that the █████ Units be sold, that █████ had a legal obligation to sell the █████ Units, that the █████ Units were not sold, and that █████ erroneously informed █████ that the █████ Units had been sold. The person was █████. Mr. █████ of █████ testified that he put together the list of unitholders based on information received from █████ and █████. █████ had actual knowledge of the █████ Letter and had access to information to determine whether the content of the █████ Letter was accurate. She therefore knew or ought to have known that █████ did not fulfill its obligation to sell the █████ Units, and that █████ had been informed that the Units had been sold.

█████ therefore knew from █████, and every day thereafter, that the █████ Units had not been sold and that █████ had been informed that the █████ Units had been sold.

Since █████ had actual knowledge that █████ had requested in █████ that the █████ Units be sold, had actual knowledge that █████ had been informed that the █████ Units had been sold, and had actual knowledge that that the █████ Units in fact had not been sold, it does not make sense to impose an obligation on █████ to inform █████ of these facts and attach legal consequences to █████ inaction, when █████ already knew all of the facts that it is now suggesting █████ should have told it.

████ Knowledge and Obligations

████ put forward a number of legal arguments (estoppel by conduct, contributory negligence, mitigation, and limitation periods (as a result of █████ not acting after it became aware or reasonably should have become aware that the shares were not sold)) in support of its claim that █████ had an obligation to notify █████ once █████ became aware (or should have become aware) that the █████ Units were not sold.

The Respondent's legal arguments can only succeed if I accept the following premise: that when █████ kept receiving from █████ \$████ per quarter after the █████ Letter, it knew or ought to have known that the █████ units were not sold, and it should have therefore contacted █████ to request that █████ sell the █████ Units or accept the consequence of not selling.

Before I look at the legal arguments, I must first determine whether █████ knew or ought to have known during █████ and █████ that the █████ Units were not sold.

I found █████, █████ and █████ all to be credible witnesses and I believed their evidence when they said that they did not know that the █████ Units had not been not sold in █████, until they were so informed in █████. I therefore find that they did not have knowledge during █████ and █████ that the █████ Units were not sold in █████.

The next issue for me to determine is whether █████ ought to have known, by virtue of receiving the payments, that the █████ Units were not sold.

████, █████ and █████ admitted that they were not sure what the payments were for, and they all characterized the payments from █████ differently (interest, dividends, etc.). █████ argued that that demonstrates that they should have at least inquired of █████ as to the nature of the payments. I disagree.

First, I don't believe that anything turns on what █████, █████ and █████ thought in terms of how the payments should be characterized. They were not sophisticated financial people (though █████ did have a Bachelor of Science in Business Administration) and they just thought of the payments as money owing by █████.

Further, the characterization of the payments changed in █████. Prior to that time, these were capital distributions; after that time, they were dividends. This would be confusing for people who did not have an accounting background. There was even some confusion in the arbitration. The joint brief of documents filed in this arbitration referred to the payments made prior to █████ as "dividends" even though they were distributions. I therefore don't draw an inference from the fact that █████, █████ and █████ were confused and not on the same page about the characterization of the payments. They all reasonably assumed that payments were owing to █████ and that these payments would not have been made by █████ to █████ if █████ believed that the payments should not have been made.

During █████ and █████, █████ and █████ were in litigation and it is clear that there was animosity between them. It was therefore reasonable for █████, █████ and █████ to conclude that, in that environment, █████ would only send money to █████ if █████ believed it had an obligation to do so.

Finally, █████ said that, in █████, he made the decision not to notify █████ of his personal discovery (that the █████ Units had not been sold in █████ despite █████ request that they be sold, and that █████ had been informed in writing that the █████ Units had been sold). He made this decision because he believed █████ *must* have known that the █████ Units were not sold. He therefore believed that if a company learns of an error, but believes that others likely know or at least ought to know of the error, the company learning of the error need not contact the others to advise them that they discovered the error.

I therefore find it ironic and challenging that █████ argues that, if █████ discovered (or should have discovered) that the █████ Units had not been sold in █████ or █████, that █████ had an obligation to inform █████ of █████ "error", even though █████ thought that █████ already *knew* the true facts. When █████ considered whether it should tell █████ of the error, it assumed █████ already knew or ought to have known the facts so it felt justified in *not* informing █████ of the discovery of the error. In other words, █████ expected █████ to act in a way that █████ did not feel it necessary to act. It therefore does not lie in the mouth of █████ to complain of conduct by █████ when █████, by its own action (or inaction), supported a policy whereby a company need not inform another of a potential error if one believes that the other company knows of or ought to know of the error.

To summarize my conclusion on this point, I find that █████ did not know and ought not to have known that the █████ Units were not sold in █████ until they were informed of that fact just prior to the delivery of the shares to them in █████. As soon as █████ learned that the █████ Units had not been sold, they immediately sold them and mitigated their damages.

Because of my finding that █████ did not know and ought not to have known that the █████ Units were not sold in █████ (until they learned about the error in █████), I do not find it necessary to review in detail the legal arguments put forward by █████ as they are all dependent on my finding that █████ had knowledge (or should have had knowledge) at some point during █████ or █████ that the █████ Units were not sold in █████.

█████ Unit Price

The █████ Agreement requires that, if █████ elects to sell its █████ Units upon █████ termination from █████, the effective date is the date of termination. In the letter from █████ to █████ dated █████, requesting that the █████ Units be sold, reference is made to the fact that the effective date for the sale of the █████ Units is █████, the date of termination. In the █████ Letter, █████ confirmed that the valuation date for the █████ Units is █████.

On █████, the price of █████ Units was \$█████ per unit. █████ said in the █████ Letter that the value of the █████ Units was determined to be \$█████. She used this figure because it was the average price over the 30 days prior to █████. If the █████ Units had been sold internally to █████ employees, that would have been the value used.

Nowhere in the Purchase Agreement does it state that the value of the █████ Units should be based on an average of the prior 30 days if █████ is terminated and █████ elects to sell the █████ Units.

█ had argued that, if the shares had been sold into the market, they likely would have received less than \$█ per unit. Of course, there is no way to know that. It is also possible that there would have been a buyer willing to buy all of the shares at the closing price. I cannot assume that the amount received necessarily would have been lower than the closing price. Also, nowhere in the Purchase Agreement does it say that if a large volume of █ Units is to be sold, an assumed price will be lower than the market price at the close of business.

The Purchase Agreement was drafted by █ and, to the extent that there is ambiguity about the price to be used, such ambiguity should be resolved in favour of █.

We know that the closing price on █ was \$█ per unit. In my view, that is the appropriate price to apply to value the shares as at █. I therefore find that the proper price to apply is \$█ per unit.

I should note that █ argued that there is a limitation problem in █ arguing for an █ Unit Price of \$█ because █ first became aware of this issue in █, notified █ at that time that █ did not agree with the price set, but did not start the action against █ until over two years after that. However, once █ brought the issue to █ attention, it had the option of commencing an action at that time, or waiting to see if █ followed through on its contractual obligations and paid the \$█ per unit █ (*Ali v. O-Two Medical Technologies Inc.*, 2013 CarswellOnt 17092 (Ont. C.A.)). Once █ knew that █ would not fulfill its contractual obligation, the limitation period then started to run and █ commenced its action before the limitation period expired.

Payment to █ Unitholders as at █

A distribution to █ unitholders as at █ was paid to █ on █, █ and the parties disagree with respect to whether that payment should have been made. (I note that the parties agree all payments made after the █ Letter was sent must be set off against any money owing by █ to █.)

█ requested in its letter dated █ that the █ Units be sold “as of the termination date”, in accordance with the █ Agreement. The █ Letter says that the █ Units were sold as at █. As I am placing █ in a position it would have been in if the █ Units had been sold on █, █ would not have been a unitholder as at █ if the █ Units had been sold on █.

█ made the decision in █ to sell the █ Units as at █. One factor █ did take, or could have taken, into account in deciding whether to sell the █ Units at that time, was that if █ had held onto the █ Units, it would have been a unitholder as at █.

I therefore find that the payment made to █ in relation to the █ payment should be set off against the amount owing to █ in the same manner as the other payments are to be set off.

Damages

As there was an admitted breach of contract and misrepresentation by [REDACTED], and as I have found that [REDACTED] did not act so as to eliminate or reduce the damages that flow from the breach and misrepresentation, I must determine the damages that are owing to [REDACTED].

The value of the [REDACTED] Units as at [REDACTED] was \$ [REDACTED] per unit. The proceeds from the sale of the [REDACTED] [REDACTED] Units would have therefore been \$ [REDACTED]. I must add the amount of interest that would have been payable to [REDACTED] if the [REDACTED] Units had been sold in [REDACTED] and the proceeds held in escrow. That amount would have been \$ [REDACTED]. From the total, I must subtract the net amount received on the sale of the [REDACTED] Units by [REDACTED] in [REDACTED] (\$ [REDACTED]), the amount actually received by [REDACTED] during the two years including the [REDACTED] distribution (\$ [REDACTED]), and the interest on the payments received during the two year period (\$ [REDACTED]). This takes me to a total amount owing of \$ [REDACTED]. Pre-judgment interest of [REDACTED] % per annum should be added to this amount.

Costs

I order costs payable by [REDACTED] to [REDACTED] on a partial indemnity basis. If the parties cannot agree on the amount of costs to be paid, they should inform me by [REDACTED] and I will set a schedule for submission of arguments.

In conclusion, I want to thank counsel for their helpful presentations during this arbitration.

Allan J. Stitt
[REDACTED]
Toronto, Ontario