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Strother v. 3464920 Canada Inc.

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The Facts
3464920 Canada Inc. (formerly, Monarch Entertainment Corporation) marketed tax-shelter investments related to the film industry in Canada. Monarch engaged tax lawyer Robert Strother and the law firm of Davis & Company ("Davis"). The written retainer (the "Initial Retainer") expressly prohibited Davis from acting for others in relation to these tax-sheltered schemes. In November 1996, the government subsequently amended the *Income Tax Act* to defeat the tax-shelters. Strother concluded that there was no "fix" to avoid the effect of the new tax rules. Monarch sought Strother's advice to salvage the business as it was being wound down. Strother deferred the discussion to the new year. The Initial Retainer expired and Monarch continued as a Davis client pursuant to a new oral retainer that was limited in scope (the "Limited Retainer"). Monarch later requested advice from Strothers regarding the availability of business opportunities in light of the new tax rules.

In late 1997 or early 1998, Paul Darc, a former executive of Monarch, approached Strother to discuss a new idea for a film production tax-shelter business that would not be barred by the new rules. Strother accepted Darc as a client and drafted a proposal that was submitted to Revenue Canada for approval. In the event of a favourable advanced ruling, Strother was to receive a substantial share of the profits of the new company, Sentinel Hill Entertainment Corporation ("Sentinel"). In October 1998, Revenue Canada issued such a favourable ruling. Throughout 1998 and 1999, Davis continued to do work for Monarch but never advised Monarch of Darc's idea or Revenue Canada's ruling. In

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The Decisions Below

After learning of Sentinel's tax ruling, Monarch sued Strother and Davis for, among other things, breach of fiduciary duty and breach of confidence. The trial judge dismissed Monarch's claim finding that Strother's fiduciary obligation to Monarch was defined by the limited scope of the Retainer and that no Monarch confidential information had been disclosed or used in providing services to Darc and Sentinel. The Court of Appeal substantially allowed the appeal on the grounds that Monarch was an ongoing client of the Davis firm. Strother had a conflict of duty between two existing clients, Monarch and Sentinel, and a conflict of interest between himself and Monarch throughout 1998, as Strother had an ongoing duty to advise Monarch of any developments in the field. The Court of Appeal ordered Strother to disgorge all profits and other benefits received from Sentinel. Strother and Davis appealed, and Monarch cross-appealed the dismissal of its claims against Darc and Sentinel.

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The SCC

At the Supreme Court, the Strother appeal on liability was dismissed and allowed in part on the issue of remedy. The Davis appeal was allowed in part and Monarch's cross-appeal was dismissed. The SCC held that when a lawyer is retained, the scope of the retainer is governed by contract as well as fiduciary responsibilities that overlay the relationship. The key issue was the scope of the continuing Limited Retainer, which was specifically limited to "tax-assisted business opportunities." Subject to confidentiality considerations, if Strother knew tax-efficient methods for the film production services business, the Limited Retainer entitled Monarch to be told. Davis and Strother failed to provide candid and proper legal advice on all matters relevant to the ongoing retainer.

While damages did not flow from the contractual breach, Strother did breach fiduciary duties owed to Monarch. Strother and Davis were free to take on Darc and Sentinel as new clients once the "exclusivity" provision of the Initial Retainer expired. Their retainer with Sentinel was also not directly adverse to any immediate interest of Monarch. The difficulty was that Strother had aligned his personal financial interests with Sentinel's success which gave Strother reason to keep Monarch in the dark on his changing views of the potential for film production tax shelters. This created a conflict between his duty to his client Monarch and his personal financial interest. Strother's appeal on remedy was allowed in part. Strother was ordered to account to Monarch for personal profits gained from Sentinel and all earnings as a partner at Davis, resulting from his work for Monarch. Davis' appeal was allowed in part. While Davis committed no direct breach of fiduciary

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duty pursuant to the B.C. *Partnership Act.*

McLachlin C.J., Bastarache, LeBel and Abella JJ. dissented. They found that the trial judge had made clear findings of fact as to the limited scope of the Limited Retainer. However, the dissenters held that the contractual obligations of the Limited Retainer narrowed the fiduciary obligation owed by Strother. They held that only if Monarch had specifically asked Strother for advice on new film tax-shelter opportunities, and if Strother had agreed to give that advice, could Strother have been under any fiduciary duty to (a) provide Monarch with continuing advice on developments of interest, and (b) to act exclusively for Monarch. In the absence of such duty, there was no conflict between Monarch and Sentinel. The dissenters held that the SCC should not revisit these factual findings absent a palpable and overriding error. They declined to superimpose a fiduciary obligation independent of and inconsistent with the Limited Retainer as they understood it. They also held that the alleged breach, even if it were made out, caused Monarch no loss since it would not have gone into the business in any event. The dissenters would uphold the trial judge, allow Strother's appeal, and dismiss the cross-appeal.

This case raises a number of interesting points of law. I will focus on two. First, the SCC split 5 to 4 on the interpretation of the Limited Retainer, and the effect of the specific terms of the Limited Retainer in defining the scope of the fiduciary duty owed in the course of that relationship. Binnie J., writing for the Supreme Court, accepted the factual finding of the trial judge that the Limited Retainer dealt with tax-assisted business opportunities, but rejected the judge's finding as to the legal effect. The SCC held that the legal effect was to impose a fiduciary obligation based on the continuing "relationship of trust and confidence" to advise Monarch of the tax-assisted business opportunity that was available to Sentinel. By contrast, the minority seems to characterize the trial judge's conclusions as to the legal effect as findings of fact. As such, it is an interesting example of blurring the line between fact and law when determining whether an appellate court will interfere.

Second, in considering the equitable remedy of disgorgement of profits for breach of fiduciary duty, the SCC distinguished between two purposes for an equitable remedy of disgorgement, one is prophylactic and the other is restitutionary. Where disgorgement is imposed for prophylactic purposes, the relevant causation is the breach of the fiduciary duty and is measured by the defendant's gain and not the plaintiff's loss. However, in defining what amounts are required to be disgorged, the SCC carefully examined each of the sources of gain realized by Strother. The SCC also imposed a cutoff date based in part on the date the ruling became public and the extent to which Strother's profits resulted from a new consultant joining Sentinel's business. The SCC also allowed Strother to deduct all reasonable and necessary expenses incurred by him to earn the profit.

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