See paras. 52, 60, 74 76-77, 87, 88, 89, 94, 95, 97, 152-153

** Preliminary Version **

Case Name:

Strother v. 3464920 Canada Inc.

Davis & Company, a partnership, Appellant;
v.
3464920 Canada Inc. (formerly known as Monarch Entertainment Corporation), Respondent.
And between
Robert C. Strother, Appellant;
v.
3464920 Canada Inc. (formerly known as Monarch Entertainment Corporation), Respondent.
And between
Robert C. Strother, Strother Family Trust (Trust No. 1) and University Hill Holdings Inc. (formerly known as 589918 British Columbia Ltd.) (Company No. 1), Appellants;
v.
3464920 Canada Inc. (formerly known as Monarch Entertainment Corporation), Respondent.
And between
3464920 Canada Inc. (formerly known as Monarch Entertainment Corporation), Appellant;
v.
Robert C. Strother, Davis & Company, a partnership, J. Paul Darc, Pacific Cascadia Capital Corporation, Sentinel Hill Entertainment Corporation, Sentinel Hill Productions Corporation, Sentinel Hill Productions II Corporation, Sentinel Hill Productions (1999) Corporation, Sentinel Hill Management Corporation, Sentinel Hill 1999-1 Master Limited Partnership, Sentinel Hill 1999-2 Master Limited Partnership, Sentinel Hill 1999-3 Master Limited Partnership, Sentinel Hill 1999-4 Master Limited Partnership,

Sentinel Hill 1999-5 Master Limited Partnership, Sentinel Hill 1999-6 Master Limited Partnership, J. Paul Darc and Leslie Marie Darc, Trustees of the Darc Family Trust, and the said Darc Family Trust, Sentinel Hill 1998 Master Limited Partnership, Sentinel Hill 1998-2 Master Limited Partnership, Sentinel Hill Productions No. 5 Limited Partnership, Sentinel Hill Productions No. 7 Limited Partnership, Sentinel Hill 1999 Master Limited Partnership, Sentinel Hill Ventures Corporation, Sentinel HillAlliance Atlantis Equicap Millenium Limited Partnership, Sentinel Hill Productions III Corporation, Sentinel Hill Alliance Atlantis Equicap Limited Partnership,Sentinel Hill GP Corporation, Company No. 1, Company No. 2,Company No. 3, Company No. 4, Company No. 5, Company No. 6, Company No. 7, Company No. 8, Company No. 9, Company No. 10, Partnership No. 1, Partnership No. 2, Partnership No. 3, Partnership No. 4, Partnership No. 5, Partnership No. 6, Partnership No. 7, Partnership No. 8, Partnership No. 9, Partnership No. 10, Trust No. 1, Trust No. 2, Trust No. 3, Trust No. 4, Trust No. 5, Trust No. 6, Trust No. 7, Trust No. 8, Trust No. 9 and Trust No. 10, Respondents, and Canadian Bar Association, Intervener.

[2007] S.C.J. No. 24

[2007] A.C.S. no 24

2007 SCC 24

2007 CSC 24

[2007] 2 S.C.R. 177

[2007] 2 R.C.S. 177

281 D.L.R. (4th) 640

363 N.R. 123

[2007] 7 W.W.R. 381

J.E. 2007-1152

241 B.C.A.C. 108

67 B.C.L.R. (4th) 1

29 B.L.R. (4th) 175

48 C.C.L.T. (3d) 1

[2007] 4 C.T.C. 172

2007 D.T.C. 5273

2007 D.T.C. 5301

2007 CarswellBC 1201

157 A.C.W.S. (3d) 439

EYB 2007-120234

File No.: 30838.

Supreme Court of Canada

Heard: October 11, 2006;
Judgment: June 1, 2007.
Judgment on motion: October 18, 2007.

Present: McLachlin C.J. and Bastarache, Binnie, LeBel, Deschamps, Fish, Abella, Charron and Rothstein JJ.

(165 paras.)

[Editor's note: Supplementary reasons for judgment were released November 25, 2008. See [2008] B.C.J. No. 2266.]

Appeal From:

ON APPEAL FROM THE COURT OF APPEAL FOR BRITISH COLUMBIA

Legal profession -- Barristers and solicitors -- Relationship with client -- Conflict of interest -- Lawyer acting for more than one party -- Personal interest of lawyer -- Retainer -- Appeal by defendant lawyer Strother from finding that he put his own financial interest in Sentinel ahead of his duty to plaintiff Monarch, in breach of his fiduciary duty, and from order requiring him to account for and disgorge to Monarch all benefits and profits he received from Sentinel, allowed in

part -- Strother informed Monarch that he did not have a "fix" to avoid Income Tax Act amendments that would defeat Monarch's tax shelter business -- Strother later obtained for Sentinel favourable tax ruling from Revenue Canada -- No excuse for Strother not to advise Monarch of successful tax ruling.

Corporations and associations law -- Partnerships -- Partners -- Fiduciary duties -- Appeal by defendant law firm Davis & Co. from order requiring it to account for and disgorge to plaintiff Monarch all fees paid to it allowed in part -- Strother, a law partner in Davis, breached his fiduciary duty to Monarch -- Monarch's failure to establish knowledge on the part of other Davis partners of the circumstances giving rise to the conflict was crucial to an assessment of their potential liability as fiduciaries -- As partners were not aware of Strother's arrangement, they were not obligated to return fees unrelated to the breach.

Appeal by defendant lawyer Strother from finding that he put his own financial interest in one client, Sentinel, ahead of his duty to another client, plaintiff Monarch, in breach of his fiduciary duty, and from order requiring him to account for and disgorge to Monarch all benefits and profits he received from Sentinel; appeal by defendant law firm Davis & Co. from order requiring it to account for and disgorge to plaintiff Monarch all fees paid to it, pursuant to second retainer; and cross-appeal by Monarch from dismissal of its action against former employee Darc. Monarch devised and marketed tax shelter investments ("TAPSF"). The structuring of such shelters was a key element of Strother's expertise. By October 1996, a written retainer between Monarch and Davis expressly prohibited Davis from acting for clients other than Monarch in relation to the TAPSF schemes ("1997 retainer"). The 1997 retainer terminated at the end of 1997, but Monarch continued thereafter as a firm client. In November 1996, the federal Minister of Finance announced his intention to amend the Income Tax Act to defeat the tax shelters. Subsequently, Strother advised Monarch that he did not have a "fix" to avoid the amendments. By October 1997, Monarch's TAPSF business had been wound down and several employees were laid off, including defendant Darc. In the fall of 1997 or early 1998, Strother was approached by Darc to discuss potential opportunities, and Strother agreed to attempt to obtain a favourable tax ruling, in exchange for a personal benefit. Strother later told his partners that he had an "option" to acquire up to 50 per cent of the common shares of a new company called Sentinel. A favourable tax ruling was issued by Revenue Canada to Sentinel in October 1998. Throughout 1998 and into 1999, Davis continued to do some work for Monarch ("1998 retainer"). Monarch executives later claimed they had relied on Strother to advise if there was a "way around" the amendments that would allow them to resume their TAPSF business. In August 1998, Strother wrote a memorandum to the management committee of Davis about a possible conflict of interest with respect to acting simultaneously for Monarch and Sentinel/Darc, though evidence later showed his disclosure to Davis was incomplete and inaccurate. The managing partner of Davis told Strother that he would not be permitted to own any interest in Sentinel. In March 1999, Strother resigned from Davis and in April joined Darc as a 50 per cent shareholder in Sentinel. Monarch learned of Sentinel's tax ruling through word of mouth some four months after the ruling was granted.

HELD: Appeal by Strother allowed in part; appeal by Davis & Co. allowed in part; cross-appeal by Monarch against Darc dismissed. The solicitor-client relationship created by retainer was overlaid with certain fiduciary responsibilities. Fiduciary duties provided a framework within which the lawyer performed the work and could include obligations that went beyond what the parties expressly bargained for, including the duty of loyalty, of which an element was the avoidance of conflicts of interest. There was no excuse for Strother not to advise Monarch of the successful tax ruling when it was made public in October 1998; both he and Davis failed to provide candid and proper legal advice in breach of the 1998 retainer. However, Monarch could not succeed in a claim for damages for breach of the contract of retainer because it did not establish any damages flowing from the alleged breach. Nevertheless, Strother's personal interest in Sentinel did come into conflict with Strother's fiduciary duty to avoid conflicts of interest in performing the contractual obligations assumed under the 1998 retainer. Davis and Strother were free to take on Darc and Sentinel as new clients once the "exclusivity" arrangement in the 1997 retainer expired. Yet Strother was not free to take a personal financial interest in the Darc/Sentinel venture. Also, Strother's failure to revisit his 1997 advice in 1998 at a time when he had a personal, undisclosed financial interest in Sentinel breached his duty of loyalty to Monarch. Disgorgement was imposed against Strother to serve a prophylactic purpose, where the relevant causation was the breach of a fiduciary duty and Strother's gain. Strother was required to account to Monarch for all monies received during or attributable to his period with Davis between January 1998 and March 1999. With respect to the claim against Davis, Monarch's failure to establish knowledge on the part of other Davis partners of the circumstances giving rise to the conflict was crucial to an assessment of their potential liability as fiduciaries. Therefore, the fees Davis charged Monarch for general corporate services and "clean-up" work on prior transactions were not tainted and a return of such fees charged in 1998 or 1999 was not ordered. Also, profits earned by Davis on the fees paid by Sentinel were a result of Davis properly accepting the Sentinel retainer and Davis lawyers providing the legal services for which the fees were charged. However, profit earned by Strother through the Davis firm allocation process at a time when Strother was in a position of conflict should form part of Strother's accounting to Monarch. The cross-appeal against Darc was dismissed for the reasons given by the Court of Appeal.

Statutes, Regulations and Rules Cited:

Income Tax Act, R.S.C. 1985, c. 1 (5th Supp.), s. 18.1(15)(b)

Partnership Act, R.S.B.C. 1996, c. 348, s. 11, s. 12, s. 14

Subsequent History:

NOTE: This document is subject to editorial revision before its reproduction in final form in the Canada Supreme Court Reports.

Court Catchwords:

Law of professions -- Barristers and solicitors -- Duty of loyalty -- Conflict of interest -- Client suing lawyer and law firm for breach of fiduciary duty and breach of confidence after lawyer took a financial interest in a second client in same line of business -- Trial judge dismissing claim but Court of Appeal ordering lawyer to disgorge to first client all benefits and profits received or receivable from second client's companies and ordering law firm to disgorge profits earned in form of legal fees from second client -- Whether lawyer breached fiduciary duty owed to first client by accepting personal financial interest in second client -- Whether lawyer wrongly used confidential information belonging to first client.

Commercial law -- Partnerships -- Vicarious liability -- Client suing lawyer and law firm for breach of fiduciary duty and breach of confidence after lawyer took a financial interest in a second client in same line of business -- Whether law firm liable for lawyer's breach of fiduciary duty -- Whether words "wrongful act or omission" in s. 12 of Partnership Act include equitable wrong -- Whether wrongful act was "in the ordinary course of the business" of law firm - - Partnership Act, R.S.B.C. 1996, c. 348, s. 12.

Equity -- Remedies -- Breach of fiduciary duty -- Disgorgement of profit -- Client suing lawyer and law firm for breach of fiduciary duty and breach of confidence after lawyer took a financial interest in a second client in same line of business -- Trial judge dismissing claim but Court of Appeal ordering lawyer to disgorge to first client all benefits and profits received or receivable from second client's companies and ordering law firm to disgorge profits earned in form of legal fees from second client -- Whether remedy ordered appropriate -- Whether period during which profits must be accounted for appropriate -- Whether lawyer's profit should be apportioned.

Court Summary:

In the 1990s, Monarch devised and marketed tax shelter investments whereby Canadian taxpayers, through ownership of units in a limited partnership, provided film production services to American studios making films in Canada. In 1996 and 1997, Monarch engaged S and the appellant law firm pursuant to written retainer agreements. The retainer expressly prohibited the firm from acting for clients other than Monarch in relation to the tax-shelter schemes (with limited exceptions). The written retainer terminated at the end of 1997, but Monarch continued thereafter as a firm client. In November 1996, the federal Minister of Finance announced his intention to amend the *Income Tax Act* to defeat the tax shelters. This was done by the introduction of Matchable Expenditures Rules. Subsequently, S advised Monarch that he did not have a "fix" to avoid the effect of the Rules. By the end of October 1997, Monarch's tax-shelter business was winding down. Several employees were laid off, including D.

In late 1997 or early 1998, D approached S to discuss the potential of revised tax-assisted film production services opportunities. S drafted a proposal that was submitted to Revenue Canada in March of 1998. S and D had agreed in January 1998 that S would receive 55 percent of the first $2 million of profit of the new company Sentinel should the tax ruling be granted and 50 percent

thereafter. S did not tell Monarch about the possibility of a revival in the film production services business at any time. A favourable tax ruling was issued by Revenue Canada to Sentinel in October 1998. S did not advise Monarch of the existence of this ruling. A further ruling addressing studio concerns was issued in December. Throughout 1998 and into 1999, the law firm continued to do some work for Monarch on outstanding matters relating to film production services transactions as well as unrelated general corporate work. In August 1998, S wrote a memorandum to the management committee of the firm about a possible conflict of interest with respect to acting simultaneously for Monarch and D/Sentinel. The memo referred, inaccurately, to S only having an option to acquire up to 50 percent of the common shares of Sentinel. The firm's managing partner told S that he would not be permitted to own any interest in Sentinel.

Effective March 31, 1999, S resigned from the law firm and in April joined D as a 50 percent shareholder in Sentinel. After learning of Sentinel's tax ruling, Monarch sued S and the firm for breach of fiduciary duty and breach of confidence. The trial judge dismissed the claim. The Court of Appeal substantially allowed the appeal and ordered S to account for and disgorge to Monarch all benefits and profits received or receivable from Sentinel. It also ordered that the law firm disgorge the profits it earned in the form of legal fees from acting for Sentinel in breach of its duty to Monarch from January 1, 1998 and return to Monarch all fees paid by it from that date. S and the law firm appealed, and Monarch cross-appealed the dismissal of its claims against D and Sentinel.

Held (McLachlin C.J. and Bastarache, LeBel and Abella JJ. dissenting in part on the appeals): The appeals should be allowed in part and the cross-appeal dismissed.

*Per***Binnie**, Deschamps, Fish, Charron and Rothstein JJ.: When a lawyer is retained by a client, the scope of the retainer is governed by contract. The solicitor-client relationship thus created is, however, overlaid with certain fiduciary responsibilities, which are imposed as a matter of law. Fiduciary duties provide a framework within which the lawyer performs the work and may include obligations that go beyond what the parties expressly bargained for. Fiduciary responsibilities include the duty of loyalty, of which an element is the avoidance of conflicts of interest. [paras. 34-35]

The subject matter of the 1998 retainer was "tax-assisted business opportunities". Subject to confidentiality considerations for other clients, if S knew there was still a way to continue to syndicate U.S. studio film production expenses to Canadian investors on a tax-efficient basis, the 1998 retainer entitled Monarch to be told that S's previous negative advice was now subject to reconsideration. While generally a lawyer does not have a duty to alter a past opinion in light of a subsequent change of circumstances, there are exceptions to the general rule. Here Monarch's written 1997 retainer had come to an end but the solicitor-client relationship based on a continuing (if more limited) retainer in relation to tax assisted film production services carried on into 1998 and 1999. [para. 40] [para.43] [paras. 45-46]

The issue here was not so much a duty to alter a past opinion, as it was part of S's duty to provide

candid advice on all matters relevant to the continuing 1998 retainer. Moreover, there was no excuse for S not to advise Monarch of the successful tax ruling when it was made public in October 1998. As it turned out, Monarch did not find out about it until February or March 1999. Accordingly, the firm (and S) failed to provide candid and proper legal advice in breach of the 1998 retainer. However, Monarch cannot succeed in a claim for damages for breach of the contract of retainer because it did not establish any damages flowing from the alleged contractual breach. The issue therefore moves to fiduciary duties. [paras. 46-48]

The firm and S were free to take on D and Sentinel as new clients once the "exclusivity" arrangement with Monarch expired at the end of 1997. The retainer by Sentinel was not directly adverse to any immediate interest of Monarch. Issues of confidentiality are routinely dealt with successfully in law firms. S could have managed the relationship with the two clients as other specialist practitioners do, by being candid with their legal advice while protecting from disclosure the confidential details of the other client's business. S accepted Sentinel as a new client and the firm was given no reason to think that he and his colleagues could not provide proper legal advice to both clients. Commercial conflicts between clients that do *not* impair a lawyer's ability to properly represent the legal interests of both clients will not generally present a conflict problem. Whether or not a real risk of impairment exists will be a question of fact. The risk did not exist here if the necessary even-handed representation had not been skewed by S's personal undisclosed financial interest. [para. 52] [para. 55] [para. 65]

In each case where no issue of potential abuse of confidential information arises, the court should evaluate whether there is a serious risk that the lawyer's ability to properly represent the complaining client may be adversely affected, and if so, what steps short of disqualification (if any) can be taken to provide an adequate remedy to avoid this result. [para. 59]

S was not free to take a personal financial interest in the D/Sentinel venture. The difficulty is not that Sentinel and Monarch were potential competitors. The difficulty is that S aligned his personal financial interest with the former's success. By acquiring a substantial and direct financial interest in one client (Sentinel) seeking to enter a very restricted market related to film production services in which another client (Monarch) previously had a major presence, S put his personal financial interest into conflict with his duty to Monarch. The conflict compromised S's duty to "zealously" represent Monarch's interest. Taking a direct and significant interest in the potential profits of Monarch's commercial competitor created a substantial risk that his representation of Monarch would be materially and adversely affected by consideration of his own interests. In time, the risk became a fact. [paras. 66-67] [para. 69]

The firm, for its part, did not breach its fiduciary duty to Monarch. The firm's partners were innocent of S's breach. The firm cannot be held to have breached a fiduciary duty on the basis of facts of which its partners were ignorant. [98]

Equitable remedies are always subject to the discretion of the court. In these circumstances,

disgorgement is imposed on faithless fiduciaries to serve a prophylactic purpose. Denying S profit generated by the financial interest that constituted his conflict teaches that conflicts of interest do not pay. The *prophylactic* purpose thereby advances the policy of equity, even at the expense of a windfall to the wronged beneficiary. However, the Court of Appeal imposed an excessive award of compensation against S and his appeals should therefore be allowed in part. The prophylactic purpose would be served if S is required to account to Monarch for all monies received during or attributable to his period with the firm between January 1, 1998 and March 31, 1999. At that point, both Monarch and S had severed their links with the firm, and the conflict was spent. [para. 1] [para. 74] [para. 77] [para. 95]

The law firm's appeal should be allowed in part. While the firm committed no breach of fiduciary duty to Monarch, it is liable for S's breaches of fiduciary duty, of which its partners are innocent, only because of the terms of s. 12 of the B.C. *Partnership Act*. The words "wrongful act or omission" in s. 12 are broad enough to embrace an equitable wrong, and S's wrongful act was so connected with the firm's ordinary business that it led to a breach of Monarch's retainer of the firm. The firm is accordingly liable under the Act with S to account for S's profits for the period from January 1, 1998 to March 31, 1999. [para. 1] [para. 100] [para. 106] [para. 111] [paras. 113-114]

A return of the fees charged to Monarch by the law firm in 1998 and 1999 for general corporate services and "clean-up" work on prior transactions should not be ordered. However, to the extent S personally made a profit under the firm allocation process attributable to hours docketed to Monarch's account, or to fees paid to the firm by Monarch, such profit (earned at a time when S was in a position of conflict, and derelict in his duty to Monarch) should form part of S's accounting to Monarch. The legal fees paid by Sentinel to the firm cannot be said to be in consequence of breaches of fiduciary duties owed by the firm to Monarch since there was no conflict known to the firm that prevented it from acting for both Sentinel and Monarch. These fees therefore do not have to be disgorged. [para. 80] [para. 83]

While some of the clauses in the Sentinel documents were almost identical to those in Monarch's production services agreement, it is not enough to show that a particular transaction document has its "genesis" in a prior transaction document. Monarch failed to establish a breach of confidence and its claim in that regard was properly dismissed. [paras. 110-111]

Monarch's cross-appeal against D should be dismissed for the reasons given by the Court of Appeal. [para. 112]

*Per***McLachlin** C.J. and Bastarache, LeBel and Abella JJ. (dissenting in part on the appeals): A conflict of interest arises when a lawyer puts himself or herself in a position of having irreconcilable duties or interests. The starting point in determining whether a conflict arose in a particular case is the contract of retainer between the lawyer and the complaining party. The nature and scope of a lawyer's retainer is purely a factual question on which the trial judge's findings should not ordinarily be upset on appeal save for error arising from misapprehension of the evidence. This is especially

true where, as here, the alleged breach is an ethical one. The question then is whether these duties conflicted with the lawyer's duties to a second client, or with his or her personal interests. If so, the lawyer's duty of loyalty is violated, and breach of fiduciary duty is established. The duty of loyalty is not a duty in the air, but is attached to the obligations the lawyer has undertaken pursuant to the retainer. [para. 132] [paras. 134-135] [para. 142]

Here the trial judge was correct to begin by asking what the contract obliged S to do for Monarch. Whatever S undertook to do, he was bound to do it with complete loyalty in accordance with his fiduciary obligation. The trial judge did not misapprehend the evidence and therefore there is no basis to overturn his findings. Given the limited nature of the retainer in 1998, there was no conflict between what S agreed to do for Monarch and what he was doing for D and himself with Sentinel. Neither S's obligation to D and Sentinel, nor his taking of a personal interest in Sentinel's profits, directly conflicted with his duties to Monarch. The Monarch retainer permitted S to take on new clients or interests. Only if Monarch had specifically asked S for advice on new film tax-shelter opportunities and S had agreed to give that advice could S have been under any duty to provide Monarch with such advice, placing him in a conflict of interest with Sentinel. On the trial judge's findings, this never happened. [para. 143] [para. 145]

The Court of Appeal erred in holding that S's duty to Monarch extended beyond the terms of the 1998 retainer agreement, grounding an on-going duty to advise Monarch of any developments in the film production tax-shelter business. The trial judge made clear findings of fact as to the limited scope of the retainer between the firm and Monarch, and on this basis concluded that no conflict arose when S took on a second client in the same line of business. The trial judge's findings stand unimpeached, and on the applicable law he correctly concluded that S did not breach his contractual or fiduciary duty to Monarch. [para. 119] [para. 131] [para. 150]

Monarch's cross-appeal should be dismissed for the reasons given by the Court of Appeal and endorsed by the majority. [para. 164]

Cases Cited

By Binnie J.

Applied: *R. v. Neil*, [2002] 3 S.C.R. 631, 2002 SCC 70; **referred to:** *MacDonald Estate v. Martin*, [1990] 3 S.C.R. 1235; *De Beers Canada Inc. v. Shore Gold Inc.*, [2006] S.J. No. 210 (QL); *Dobbin v. Acrohelipro Global Services Inc.* (2005), 246 Nfld. & P.E.I.R. 177, 2005 NLCA 22; *Canadian Aero Services Ltd. v. O'Malley*, [1974] S.C.R. 592; *Hilton v. Barker Booth and Eastwood*, [2005] 1 All E.R. 651; *Côté v. Rancourt*, [2004] 3 S.C.R. 248, 2004 SCC 58; *Ramrakha v. Zinner* (1994), 157 A.R. 279; *Stewart v. Canadian Broadcasting Cor*p. (1997), 150 D.L.R. (4th) 24; *Credit Suisse First Boston Canada Inc., Re* (2004), 2 B.L.R. (4th) 109; *Chiefs of Ontario v. Ontario* (2003), 63 O.R. (3d) 335; *Bolkiah v. KPMG*, [1999] 2 A.C. 222; *Kelly v. Cooper*, [1993] A.C. 205; *Williams v. Reed*, 29 F. Cas. 1386 (1824); *Martin v. Goldfarb* (1998), 41 O.R. (3d) 161; *Waxman v. Waxman* (2004), 186 O.A.C. 201; *Uniform Custom Countertops Inc. v. Royal Designer Tops Inc.*, [2004] O.J.

No. 3090 (QL); *de Guzman v. de la Cruz*, [2004] B.C.J. No. 72 (QL), 2004 BCSC 36; *Celanese Canada Inc. v. Murray Demolition Corp.*, [2006] 2 S.C.R. 189, 2006 SCC 36; *R. v. Speid* (1983), 43 O.R. (2d) 596; *Coutu v. Jorgensen* (2004), 202 B.C.A.C. 67; *Nocton v. Lord Ashburton*, [1914] A.C. 932; *R. v. Shamray* (2005), 191 Man. R. (2d) 55, 2005 MBQB 1; *R. v. Henry* (1990), 61 C.C.C. (3d) 455; *Wewaykum Indian Band v. Canada*, [2002] 4 S.C.R. 245, 2002 SCC 79; *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377; *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534; *Chan v. Zacharia* (1984), 154 C.L.R. 178; *Bray v. Ford*, [1896] A.C. 44; *Warman International Ltd. v. Dwyer* (1995), 128 A.L.R. 201; *MacMillan Bloedel Ltd. v. Binstead* (1983), 22 B.L.R. 255; *McDonic Estate v. Hetherington (Litigation Guardian of)* (1997), 31 O.R. (3d) 577; *Dubai Aluminium Co. v. Salaam*, [2003] 2 A.C. 366; *Bazley v. Curry*, [1999] 2 S.C.R. 534; *Jacobi v. Griffiths*, [1999] 2 S.C.R. 570; *E.D.G. v. Hammer*, [2003] 2 S.C.R. 459, 2003 SCC 52; *K.L.B. v. British Columbia*, [2003] 2 S.C.R. 403, 2003 SCC 51; *Blackwater v. Plint*, [2005] 3 S.C.R. 3, 2005 SCC 58; *E.B. v. Order of the Oblates of Mary Immaculate in the Province of British Columbia*, [2005] 3 S.C.R. 45, 2005 SCC 60.

By McLachlin C.J. (dissenting in part)

Hilton v. Barker Booth and Eastwood, [2005] 1 All E.R. 651; *R. v. Neil*, [2002] 3 S.C.R. 631, 2002 SCC 70; *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377; *Smith v. McInnis*, [1978] 2 S.C.R. 1357; *Hospital Products Ltd. v. United States Surgical Corp.* (1984), 156 C.L.R. 41; *Kelly v. Cooper*, [1993] A.C. 205; *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235, 2002 SCC 33; *Bristol and West Building Society v. Mothew*, [1996] 4 All E.R. 698; *Armitage v. Nurse*, [1997] 2 All E.R. 705; *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534; *Bazley v. Curry*, [1999] 2 S.C.R. 534.

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History and Disposition:

APPEALS and CROSS-APPEAL from judgments of the Court of Appeal for British Columbia (Newbury, Hall and Oppal JJ.A.) (2005), 38 B.C.L.R. (4th) 159, 208 B.C.A.C. 39, 1 B.L.R. (4th) 302, 28 C.C.L.T. (3d) 159, [2005] 3 C.T.C. 168, 2005 D.T.C. 5059, 5 W.W.R. 108, [2005] B.C.J. No. 80 (QL), 2005 BCCA 35, and (Newbury, Hall and Levine JJ.A.) (2005), 44 B.C.L.R. (4th) 275, 215 B.C.A.C. 9, 8 B.L.R. (4th) 4, 256 D.L.R. (4th) 319, 47 C.C.E.L. (3d) 159, [2005] 11 W.W.R. 399, [2005] 5 C.T.C. 107, [2005] B.C.J. No. 1655 (QL), 2005 BCCA 385 - setting aside in part a decision of Lowry J. (2002), 26 B.L.R. (3d) 235, [2003] 1 C.T.C. 88, 2002 D.T.C. 7329, [2002] B.C.J. No. 1982 (QL), 2002 BCSC 1179. Appeals allowed in part, McLachlin C.J. and Bastarache, LeBel and Abella JJ. dissenting in part. Cross-appeal dismissed.

Counsel:

Irwin G. Nathanson, Q.C., Ardella A. Thompson and *Geoffrey Gomery*, for the appellant/respondent Davis & Company, a partnership.

Rose-Mary Liu Basham, Q.C., Robert D. Holmes and *Leslie J. Muir*, for the respondent/appellant 3464920 Canada Inc. (formerly known as Monarch Entertainment Corporation).

George K. Macintosh, Q.C., J. Kenneth McEwan, Q.C., and *Robin M. Elliot, Q.C.*, for the appellants/respondents Robert C. Strother, the appellants Strother Family Trust (Trust No. 1) and University Hill Holdings Inc. (formerly known as 589918 British Columbia Ltd.) (Company No. 1), and the respondents Partnership No. 1, Partnership No. 2, Partnership No. 3, Partnership No. 4, Partnership No. 5, Partnership No. 6, Partnership No. 7, Partnership No. 8, Partnership No. 9, Partnership No. 10, Trust No. 1, Trust No. 2, Trust No. 3, Trust No. 4, Trust No. 5, Trust No. 6, Trust No. 7, Trust No. 8, Trust No. 9 and Trust No. 10.

Kenneth N. Affleck, Q.C., Lisa A. Warren and *Michael J. Sobkin*, for the respondents J. Paul Darc, Pacific Cascadia Capital Corporation, Sentinel Hill Entertainment Corporation, Sentinel Hill Productions Corporation, Sentinel Hill Productions II Corporation, Sentinel Hill Management Corporation, J. Paul Darc and Leslie Marie Darc, Trustees of the Darc Family Trust, and the said Darc Family Trust, Company No. 1, Company No. 2, Company No. 3, Company No. 4, Company No. 5, Company No. 6, Company No. 7, Company No. 8, Company No. 9 and Company No. 10.

David C. Harris, Q.C., and *Andrea N. Mackay*, for the respondents Sentinel Hill Productions (1999) Corporation, Sentinel Hill 1999-1 Master Limited Partnership, Sentinel Hill 1999-2 Master Limited Partnership, Sentinel Hill 1999-3 Master Limited Partnership, Sentinel Hill 1999-4 Master Limited Partnership, Sentinel Hill 1999-5 Master Limited Partnership, Sentinel Hill 1999-6 Master Limited Partnership, Sentinel Hill 1998 Master Limited Partnership, Sentinel Hill 1998-2 Master Limited Partnership, Sentinel Hill Productions No. 5 Limited Partnership, Sentinel Hill Productions No. 7 Limited Partnership, Sentinel Hill 1999 Master Limited Partnership, Sentinel Hill Ventures Corporation, Sentinel Hill Alliance Atlantis Equicap Millenium Limited Partnership, Sentinel Hill Productions III Corporation, Sentinel Hill Alliance Atlantis Equicap Limited Partnership and Sentinel Hill GP Corporation.

Terrence J. O'Sullivan and *M. Paul Michell*, for the intervener the Canadian Bar Association.

[Editor's note: A judgment on motion was released October 18, 2007. The text of the motion is appended to the end of this judgment.]

The judgment of Binnie, Deschamps, Fish, Charron and Rothstein JJ. was delivered by

1 BINNIE J.:-- A fundamental duty of a lawyer is to act in the best interest of his or her client to the exclusion of all other adverse interests, except those duly disclosed by the lawyer and willingly accepted by the client. The appellant Robert Strother, a successful tax partner with the appellant Davis & Company ("Davis") in Vancouver, was found by the Court of Appeal of British Columbia to have put his own financial interest in one client (Sentinel) ahead of his duty to another client (Monarch) in breach of his fiduciary duty. Fiduciary duties provide the framework (enforced by the courts and by the Law Society of British Columbia) within which a particular contractual mandate is to be carried out. The issue here is whether (as the trial judge held) those responsibilities were sufficiently limited by the scope of the retainer so as to afford Monarch no relief; or whether, on the contrary, the fiduciary duty is broader than the trial judge thought (as held by the Court of Appeal) and was breached either by Strother or Davis or both and, if so, what the appropriate remedy is. For the reasons which follow, I conclude that the trial judge did not correctly construe the scope of Monarch's 1998 retainer of Davis and Strother, and thus did not pursue the analysis of fiduciary duty far enough. In my view, the Court of Appeal correctly analysed the retainer and found a breach of fiduciary duty by Strother. I would allow the appeal by the Davis firm, (which was an innocent party in Strother's misconduct) against any direct liability for breach of fiduciary duty, but give effect to Monarch's statutory claim against Davis for vicarious liability under the *Partnership Act*, R.S.B.C. 1996, c. 348. I also conclude that the Court of Appeal imposed an excessive award of compensation against Strother. I would therefore allow both appeals in part for the reasons which follow. Monarch's cross-appeal should be dismissed.

I. Facts

2 Monarch Entertainment Corporation ("Monarch" (now 3464920 Canada Inc.)) began promoting tax-assisted production services funding (TAPSF) investments in 1993. It was owned by Stephen Cheikes and Nova Bancorp Capital Management Ltd. ("Nova"). The principal of Nova is Harry Knutson. Knutson and Cheikes were introduced to one another by Davis. Paul Darc, a chartered accountant, became Monarch's chief operating officer in 1995, but was demoted the following year to the position of chief financial officer.

A. *The Tax Scheme*

3 From 1993 to 1997, Monarch devised and marketed tax shelter investments whereby Canadian taxpayers, through ownership of units in a limited partnership, provided film production services to American studios making films in Canada. In outline, the tax shelter worked like this. Limited partnerships were established. The investors would notionally produce a film for a studio in return for a fee, paid over time, that was contingent on the success of the film. The contingency of the payment introduced a substantial element of risk, and the right to receive such speculative income at some future date was considered by Revenue Canada not to be a capital asset. Therefore, expenditures for the film production were treated as deductible from other income in the year the expenditures were incurred. The scheme yielded a loss to the partnership in the early years because of the mismatch between the front-end expenses in the year the film was made and the delayed and

uncertain return. The loss was deducted by investors from their unrelated income - thereby sheltering this income from immediate taxation. If the film was a success, the tax collector's cut would at least be deferred.

4 The American studios shared in the tax deferral benefit of the Canadian investors by an advantageous sale of their expenses of making the film to the Canadian investors. Monarch derived a profit equal to the difference between what the investors actually paid and what the studio received, less its own expenses.

B. *Monarch Retains Davis & Company*

5 Robert Strother was one of the biggest billers at Davis and in the mid-1990s Monarch was by far his biggest client (representing about half his billings). The TAPSF shelter was considered almost too good to be true; thus potential investors, fearing a government clampdown, required the assurance of a favourable advance tax ruling from Revenue Canada. The structuring of such shelters and negotiation of such rulings were key elements of Strother's expertise.

6 The fees paid to Davis were mostly determined on an agreed-upon percentage of the volume of production transactions closed each year. The trial judge found that Strother was instrumental in Monarch's success ((2002), 26 B.L.R. (3d) 235, 2002 BCSC 1179, at para. 11). In 1996 and 1997, the firm's engagement was expressed in written retainer agreements. Effective October 1996, the retainer expressly prohibited Davis from acting for clients other than Monarch in relation to TAPSF schemes (with limited exceptions). The written retainer terminated at the end of 1997, but Monarch continued thereafter as a firm client. Between 1993 and 1997 Monarch closed transactions of almost $460 million, realized more than $13 million in profits and paid Davis more than $5 million in legal fees.

C. *Emergence of Stiff Competition*

7 In 1996-1997, two other promoters entered the TAPSF business and substantially reduced Monarch's share of the market: Grosvenor Park Securities Ltd. ("Grosvenor Park") and Alliance Equicap Corporation ("Alliance"). Monarch's market share fell from almost 100 percent of the potential market in 1995 to 20 percent in 1996-1997.

D. *The Minister of Finance Decides to Close the Door*

8 In November 1996, the federal Minister of Finance announced his intention to amend the *Income Tax Act*, R.S.C. 1985, c. 1 (5th Supp.) ("ITA"), to defeat the TAPSF tax shelters. This was done by the introduction of Matchable Expenditures Rules ("MER"). Subsequently, Strother advised Monarch that he did not have a "fix" to avoid the effect of the MER. As a transitional measure, the government extended relief from the MER until the end of October 1997, but no further.

E. *Monarch Looks for Other Opportunities*

9 By the end of October 1997, Monarch's TAPSF business had been wound down. Several employees were laid off, including Paul Darc. Grosvenor Park and Alliance also stopped promoting tax shelters and went out of the TAPSF business. In late 1997, Monarch sought Strother's advice about what could be done to salvage what was left of their business, but he suggested that they defer that discussion until the new year. The trial judge held: "I find that Mr. Strother concealed nothing from Monarch in 1997 in order to take a benefit for himself" (para. 91).

F. *Strother Learns of a Possible "Fix"*

10 At the end of October or beginning of November 1997, Joel Nitikman, a tax lawyer with Fraser Milner Casgrain in Vancouver, contacted Strother and told him that he thought there might be a way around the MER and that 20th Century Fox was interested in exploring the possibility of having a film financed using a somewhat different structure (the "*Lade* idea") by the Stern Group of companies (who were also clients of Strother's) (trial judgment, at para. 66). In the course of subsequent discussions in November 1997, Nitikman discussed with Strother s. 18.1(15)(*b*) which provided that MER would not apply where more than 80.1 percent of the right to receive income was realized before the end of the year in which the expenditure was made. This meant that the maximum "loss" available for a tax deduction would be 19.9 percent of production expenses (compared to 50 percent previously).

11 Strother was unable to get a favourable advance ruling from Revenue Canada for the "*Lade*" scheme for Stern, but by the end of 1997, in connection with this initiative, Strother obtained confirmation from Revenue Canada that a favourable tax ruling was not out of the question for a film production services transaction, as long as it complied with the new rules, including s. 18.1(15)(*b*).

G. *Darc/Sentinel Becomes a Client*

12 In the fall of 1997 or early 1998, Strother was approached by Paul Darc, a former executive of Monarch, to discuss potential opportunities. Darc was working on a possible tax credit business (as opposed to a tax shelter business). Strother discussed with Darc the s. 18.1(15)(*b*) exception. Darc devised the idea of marrying a tax shelter and a tax credit business, subordinating the shelter to the credits (to ensure that the business would not run afoul of the general anti-avoidance rule of the ITA). Under Darc's plan, the studio fee would not be contingent on the success of the film but rather was fixed at 80.1 percent.

13 Darc was able to put together enough of a scheme to convince Strother to draft a nine-page proposal that was submitted to Revenue Canada in March of 1998. Although the trial judge found as a fact that Strother honestly felt throughout 1997 and even after learning of Darc's proposal that the TAPSF shelter was dead for good, Strother was obviously persuaded that Darc's scheme was worth a try, and far from holding that opinion as a disinterested lawyer, he agreed to volunteer his services

without charge to attempt to obtain the ruling, in exchange for a personal benefit. Strother later told his partners that he had an "option" to acquire up to 50 percent of the common shares of a new company called Sentinel Hill Entertainment Corporation ("Sentinel" or "Sentinel Hill"), a shelf company owned by Darc, but in fact, on the evidence, he and Darc had agreed in January 1998 that Strother would receive 55 percent of the first $2 million of profit should the tax ruling be granted and 50 percent thereafter. Out-of-pocket expenses for the ruling request were to be shared equally. Strother did not tell Monarch about the possibility of a revival in the film production services business at any time.

H. *Sentinel Obtains Advance Tax Ruling*

14 A favourable tax ruling was issued by Revenue Canada to Sentinel on October 6, 1998 based on the s. 18.1(15)(*b*) exception to the MER. A further ruling addressing studio concerns was issued in December 1998. Sentinel closed $260 million in studio production transactions by year-end of 1998. Subsequently, Grosvenor Park and Alliance obtained their own rulings and were back in the film production services business by September 1999.

I. *Monarch Was a Continuing Client of Davis/Strother*

15 In 1998, Strother met with Monarch executives on January 15, 21, 27 and May 19, June 26, July 24, August 4 and (by chance) in mid-September. They testified that they asked Strother what business opportunities might be available to Monarch in the wake of the new tax rules. They said they relied on him to advise if there was a "way around" the MER that would allow them to resume their TAPSF business. Cheikes testified in cross-examination as follows:

> Q. And I suggest, sir, that in fact that you did not -- Monarch did not approach Strother and Davis to request Strother and Davis to develop a means to amend the structure. Isn't that correct, sir?
>
> A. It's not correct. As I've said to you what happened is Monarch had a general agreement and understanding in their being represented by Davis & Company that <u>that was a principal function of the law firm for us, is when there is a change of tax law to find a way around it</u>. When the tax law was changed and we were told in 1996, November of '96, that there was absolutely no way around it, we followed Strother's advice to lobby the government, try to get an exception, and try again to get grandfathering. But we were told, and we relied absolutely on his legal advice that there was absolutely no way to get around the rules. The general instruction though of our employment stayed in effect all the time. If there is a way, Strother, if you know it now, if you know it in the future, that's your job for us. <u>Find a way to get around any changes of the law. It was first implicit, possibly not explicit at that point, but it was clearly the central part of the retention of Davis & Company and Rob Strother for our business.</u> [Emphasis added.]

(Monarch's R.R., vol. 1, at p. 84)

In his evidence-in-chief, Strother testified:

> A. And I think we had a general discussion, that I had very little recollection of, which I've, I guess come to be refreshed through the course of this litigation, and I think it was a, where-are-we-going-now meeting with Mr. Knutson where we talked about some of the things that I said earlier that we sort of put on hold while he was getting closed and, and worrying about those issues. [Emphasis added.]

(Strother's A.R., at p. 94)

In his factum, Strother emphasizes the trial judge's conclusion that

> Mr. Knutson and Mr. Cheikes were not consulting Mr. Strother for advice on the rules that had put an end to their tax shelter business or to explore whether there was any possibility of that business in some way being continued. They had no reason to do so and had no expectation of receiving any advice in that regard. [para. 24]

16 Throughout 1998 and into 1999, Davis continued to do some work for Monarch on outstanding matters relating to film production services transactions that had closed by the end of October 1997 as well as unrelated general corporate work. Through 1998 and into January 1999, Davis invoiced Monarch more than $98,000 in legal fees.

J. *Strother Makes Incomplete Disclosure to Davis of his Side-Deal with Darc*

17 On August 4, 1998, Strother wrote a memorandum to the management committee of Davis about a possible conflict of interest with respect to acting simultaneously for Monarch and Sentinel/Darc. He said that Sentinel's prospects were highly speculative and uncertain. He stated that during *the late fall of 1997* he met with Darc several times to discuss the possibility of forming a company to carry out film production services transactions (although in examination for discovery, Strother claimed that the meetings did not occur until 1998). The memo referred, inaccurately, to Strother only having "*an option* to acquire up to *50%* of the common shares" of Sentinel Hill (emphasis in original). Strother also described a conversation with an official of the Law Society of British Columbia that resulted in Strother acknowledging that because of his financial interest in Sentinel he was "potentially in technical breach" of Chapter 7 of the Law Society's *Professional Conduct Handbook* which provides:

1. Except as otherwise permitted by the *Handbook*, a lawyer shall not perform any legal services for a client in a matter in which:

   (a) the lawyer has a direct or indirect financial interest, or
   (b) anyone, including a relative, partner, employer, employee, business associate or friend of the lawyer, has a direct or indirect financial interest which would reasonably be expected to affect the lawyer's professional judgement.

2. A lawyer shall not perform any legal services for a client with whom or in which the lawyer or anyone, including a relative, partner, employer, employee, business associate or friend of the lawyer, has a financial or membership interest which would reasonably be expected to affect the lawyer's professional judgement.

The managing partner of Davis, Douglas Buchanan, told Strother that he would not be permitted to own any interest in Sentinel. Strother did not provide Buchanan with a copy of the January 30th Agreement.

K. *Strother Quits Davis*

18 Effective March 31, 1999, Strother resigned from Davis and in April joined Darc as a 50 percent shareholder in Sentinel. They hired Bradley Sherman as a consultant and sales coordinator. (Until 1997, Sherman had been the driving force behind Grosvenor Park.) Sherman and his associate, Kenneth Gordon, acquired equity positions in a new vehicle, Sentinel Hill Ventures Corporation, owned equally but indirectly by Strother, Darc, Sherman and Gordon. As a result of further affiliation, the promoters formed Sentinel Hill Alliance Atlantis Equicap Limited Partnership ("SHAAELP") that became the primary entity promoting the Sentinel Hill-Alliance business throughout 2000 and 2001.

19 By the time Parliament finally ended the late-blooming film production services transactions through further amendments to the ITA in September 2001, Sentinel and related enterprises had closed transactions exceeding $4 billion with profits approaching $130 million. Darc and Strother had together realized total profits in excess of $64 million. Davis acted for the SHAAELP throughout and received fees exceeding $9 million.

L. *Monarch Severs Relations with Davis*

20 Monarch learned of Sentinel's tax ruling through word of mouth some four months after the ruling was granted. Neither Strother nor anyone else at Davis had mentioned it. Monarch, feeling betrayed, promptly severed its relationship with Davis and threatened legal action against Strother and Darc. Monarch never reentered the film production services although it took preliminary steps

in that regard with the assistance of another law firm. These efforts were discontinued in mid-2001 when Monarch learned that the government was planning further amendments to the ITA to end such shelters for good, which Parliament did as of the end of 2001.

II. Issues

21 On these facts, the following issues emerge:

1. Did Strother and/or Davis breach a fiduciary duty owed to Monarch by accepting Darc/Sentinel as a new client?
2. Did Strother breach a fiduciary duty to Monarch by accepting a personal financial interest in Sentinel, and if so, is Davis also liable for that breach?
3. Did Strother wrongly use for his own and/or Sentinel's benefit confidential information belonging to Monarch?
4. If one or more of the above issues are resolved in favour of Monarch, what remedies lie against Strother and/or Davis and the various entities who profited by the default, if any, from 1998 to the present?

III. Judicial History

A. *Supreme Court of British Columbia* (2002), 26 B.L.R. (3d) 235, 2002 BCSC 1179

22 Lowry J. dismissed Monarch's claim. While the relationship between Monarch and Strother was fiduciary in nature, Strother's duty to advise was governed by the terms of the retainer, express or implied. He was only obliged to act in Monarch's best interests in relation to the advice he was retained to give.

23 Lowry J. noted that the scope of the Davis retainer under the 1996-97 agreement was sufficiently broad to require Strother to stay apprised, and keep Monarch apprised, of all legal developments which he recognized would affect Monarch's ability to continue to promote TAPSF investments. He found that Strother's advice to Monarch, that he had no technical fix and that, even if he could devise one, he did not consider that any advance tax ruling could be obtained, was the view he in fact held throughout 1997. Strother's pessimistic view was consistent with that held by Monarch's competitors and their tax advisers. Lowry J. concluded that in 1997 Strother gave Monarch all of the advice concerning the MER and their impact on its business that was required within the scope of the Davis 1997 retainer. He also concluded, however, that in "the latter part of 1997", when "those at Monarch looked to Mr. Strother for ideas on what, if anything, they could do ... Strother suggested some alternative tax-assisted business opportunities that could be explored. A decision was taken to defer consideration" until 1998 (para. 96).

24 The Davis retainer in 1998 was decidedly different from what it had been in 1997. There was no continuing contractual requirement for Davis to act exclusively for Monarch. Lowry J. held that after 1997, Strother was not obliged to provide any advice to Monarch that was not specifically

sought and that he agreed to give. Strother was not, on any account, required to disclose information of a competitive nature pertaining to the basis of the Sentinel Hill advance tax ruling request. Strother was free to be consulted by Darc in January 1998, and Davis was free to act for Sentinel thereafter.

25 Lowry J. observed that solicitors do not generally carry an ongoing obligation to alter advice given under a concluded retainer because of a subsequent change of circumstances provided the advice, when given, was correct. Lowry J. concluded that, in 1998, there was no advice Strother was required to give Monarch about how the s. 18.1(15)(*b*) exception might be used in a film production services scheme. Moreover, neither Darc nor Strother breached any confidences owed to Monarch. Monarch had not established that its financing structure was held in confidence. With respect to transaction documentation, Lowry J. held that solicitors are entitled to use documentation they have prepared in the course of an earlier retainer providing that by their doing so information is not disclosed which remains confidential to the client for whom the documentation was initially prepared. Lowry J. did not consider that Monarch had made out a case for a return of the fees paid to Davis.

B. *Court of Appeal for British Columbia (Newbury, Hall and Oppal JJ.A.)*(2005), 38 B.C.L.R. (4th) 159, 2005 BCCA 35 ("BCCA #1")

26 The appeal was allowed in part.

27 The court concluded that the duty of loyalty was breached by Strother in this case, and that even accepting the facts found by the trial judge, the dismissal of Monarch's claims against him could not stand. Strother was in a position of conflict in two senses - a conflict of duty between two current clients, Monarch and Sentinel, and a conflict of interest between Strother himself and Monarch, his client through 1998.

28 Newbury J.A. noted that although the term of the exclusivity/fee agreement had expired at the end of 1997, the solicitor-client relationship between Monarch and Davis continued, without the negotiation of a new written agreement. The relationship now took the form more usual between corporate clients and law firms: Monarch consulted as necessary on various matters from time to time and Strother provided advice, or seconded other lawyers to do so according to their expertise, and billed on the basis of the firm's usual hourly rates.

29 When Monarch asked "what could be done", it was entitled to an honest and complete answer, whether or not Strother had a file open for another client for continuing TAPSF work. The fact that Monarch did not ask about s. 18.1(15)(*b*) specifically, or seek repeated confirmations that Strother had not yet become aware of the possibility of a "technical fix", was not conclusive of his duty to respond candidly.

30 In Newbury J.A.'s view, the trial judge also erred in law in concluding that Strother was under no obligation to advise Monarch of the possibility that TAPSF syndication would be revived or that

Monarch should seek advice elsewhere. As soon as Strother and Darc entered into their agreement in January 1998, Strother was in a position of personal conflict - whether or not his entitlement to a "profit" or "equity" participation was immediate or contingent on obtaining a ruling. It was in his personal interest to ensure that Monarch remained ignorant of what he knew - that a "technical fix" based on s. 18.1(15)(*b*) was a possibility.

31 Newbury J.A. concluded, "[a]fter much anxious consideration", that Strother was "required to account for and disgorge to Monarch all benefits, profits, interests and advantages he ha[d] received or which he [might] hereafter be entitled to receive, directly or indirectly ... from or through any of the Sentinel Hill Entities" (para. 61). She directed a reference for this purpose. She further declared Strother, the Sentinel Hill entities and other defendants owned or controlled by him to be constructive trustees in favour of Monarch in respect of the profits, interests and benefits in question. No direct liability on the Sentinel Hill entities was warranted beyond the accounting already ordered.

C. *Supplementary Decision (Newbury, Hall and Levine JJ.A.)* (2005), 44 B.C.L.R. (4th) 275, 2005 BCCA 385 ("BCCA #2")

32 As to the vicarious liability of Davis, Newbury J.A. stated that equity would not generally order an accounting or disgorgement by an innocent person who had not received any of the profits resulting from the wrong. In the result, she dismissed Monarch's claim that Davis be required, jointly and severally with Strother, to account for the profits and benefits received or receivable by Strother from Sentinel Hill. However, she held that different considerations applied to Monarch's claim that Davis disgorge the profits *it* earned in the form of legal fees as a result of acting for Sentinel Hill in conflict with its duty to its original client, Monarch. Although it did not appear that the partners of the firm were aware of the advice Strother was giving, liability was imposed on the basis of vicarious liability. Accordingly, Newbury J.A. ordered that the law firm account for and disgorge the profits it earned from acting for Sentinel Hill in breach of its duty to Monarch from and after January 1, 1998.

33 The Court of Appeal dismissed Monarch's appeal from the trial judge's rejection of its claim that the fees (some $5,600,000) it had paid to Davis between 1993 and 1999 should be returned to it. However, the court ordered that Davis return to Monarch all fees (not including disbursements) paid by Monarch from January 1, 1998 onwards.

IV. Analysis

34 When a lawyer is retained by a client, the scope of the retainer is governed by contract. It is for the parties to determine how many, or how few, services the lawyer is to perform, and other contractual terms of the engagement. The solicitor-client relationship thus created is however overlaid with certain fiduciary responsibilities, which are imposed as a matter of law. The Davis factum puts it well:

> The source of the duty is not the retainer itself, but all the circumstances (including the retainer) creating a relationship of trust and confidence from which flow obligations of loyalty and transparency. [para. 95]

Not every breach of the contract of retainer is a breach of a fiduciary duty. On the other hand, fiduciary duties provide a framework within which the lawyer performs the work and may include obligations that go beyond what the parties expressly bargained for. The foundation of this branch of the law is the need to protect the integrity of the administration of justice: *MacDonald Estate v. Martin*, [1990] 3 S.C.R. 1235, at pp. 1243 and 1265. "[I]t is of high public importance that public confidence in that integrity be maintained": *R. v. Neil*, [2002] 3 S.C.R. 631, 2002 SCC 70, at para. 12.

35 Fiduciary responsibilities include the duty of loyalty, of which an element is the avoidance of conflicts of interest, as set out in the jurisprudence and reflected in the *Rules of Practice of The Law Society of British Columbia*. As the late Hon. Michel Proulx and David Layton state, "[t]he leitmotif of conflict of interest is the broader duty of loyalty", *Ethics and Canadian Criminal Law* (2001), at p. 287.

36 In recent years as law firms have grown in size and shrunk in numbers, the courts have increasingly been required to deal with claims by clients arising out of alleged conflicts of interest on the part of their lawyers. Occasionally, a law firm is caught innocently in crossfire between two or more clients. Sometimes the claim of conflict is asserted for purely tactical reasons, an objectionable practice criticized in *Neil* at paras. 14-15, and a factor to be taken into account by a court in determining what relief if any is to be accorded: *De Beers Canada Inc. v. Shore Gold Inc.*, [2006] S.J. No. 210 (QL), 2006 SKQB 101; *Dobbin v. Acrohelipro Global Services Inc.* (2005), 246 Nfld. & P.E.I.R. 177, 2005 NLCA 22. Sometimes, however, the dilemma is of the lawyer's own making. Here the firm's position was compromised by the personal conflict of a lawyer (Strother) who, contrary to the instructions of Davis's managing partner, contracted for a personal financial interest in one client (Sentinel) whose interest he then preferred over another client (Monarch) who now sues for compensation. In that regard, Monarch relies upon the well-known proposition endorsed by Professors Waters that:

> The other (the beneficiary) is entitled to expect that the fiduciary will be concerned solely for the beneficiary's interests, never the fiduciary's own.
>
> (D. W. Waters, "The Development of Fiduciary Obligations", in R. Johnson et al., eds., *Gerald V. La Forest at the Supreme Court of Canada, 1985-1997* (2000), 81, at p. 83)

See, in particular, *Canadian Aero Services Ltd. v. O'Malley*, [1974] S.C.R. 592. The point was restated in the context of lawyers in *Neil*, at para. 24: "Loyalty includes putting the client's business ahead of the lawyer's business". It was on this basis that Monarch succeeded in the British

Columbia Court of Appeal.

37 Robert Strother appeals to this Court. In his view, he breached no fiduciary duty to Monarch. His position is that once the "exclusivity" arrangement terminated at the end of 1997, he and Davis were free to take on new clients seeking to exploit what was left of the tax-assisted film production services market. He protests that the judgment of the Court of Appeal leaves the reader with the impression that he was "watching the clock" in order to begin working with Darc and Sentinel the moment the Monarch exclusivity provision expired (Strother factum, at para. 25). I do not think the Court of Appeal subscribed to such a conspiracy theory. Their focus was on the 1998 retainer, which is where the focus should be. As Strother sees it, he was under no duty in 1998 (unless specifically asked) to correct the advice he had given to Monarch in 1997 (which he believed to be correct at the time it was given) that he had "no fix" to the government measures designed to terminate film production services tax shelters. As 1997 ended and 1998 began, a page was turned and, in his view, neither Davis as a firm nor Strother as a partner of the firm owed any fiduciary duty to Monarch that could give rise to liability to Monarch.

38 Davis, for its part, joins in the grounds of appeal urged by Strother but in addition distances itself from the consequences of Strother's personal financial involvement with Darc and Sentinel, which its managing partner had expressly prohibited in August 1998.

A. *The Scope of the 1998 Retainer*

39 A critical issue in this case is the scope of Monarch's contractual retainer with Davis in 1998. Davis acknowledges "that a solicitor's duty of single-minded loyalty to his client's interest had its roots in the fiduciary nature of the solicitor-client relationship but that duty ... 'may have to be moulded and informed by the terms of the contractual relationship'" (Davis factum, at para. 80, citing *Hilton v. Barker Booth and Eastwood*, [2005] 1 All E.R. 651 (H.L.)). At para. 30 of the *Hilton* case, Lord Walker elaborated:

> ... On this issue of liability both sides have been content for the case to be dealt with as a claim for breach of contract. However, the content of BBE's contractual duty, so far as relevant to this case, has roots in the parties' relationship of trust and confidence.

40 Here, too, the claim arises out of "the parties' relationship of trust and confidence" but the case is pleaded as a breach of the fiduciary duty of loyalty rather than breach of contract. The critical findings of fact of the trial judge as to the scope of the retainer include the following:

> ... In 1998, Mr. Strother's contact with Monarch was quite limited but, arising out of suggestions he made during 1997 regarding the possibility of exploring <u>alternative tax-assisted business opportunities</u>, he was consulted to some extent by Mr. Knutson and Mr. Cheikes... .

...

> During the latter part of 1997, those at Monarch looked to Mr. Strother for ideas on what, if anything, they could do with Monarch's resources in light of the fact that tax-sheltered financing and their production services investment business was ended. Mr. Strother suggested some alternative tax-assisted business opportunities that could be explored. A decision was taken [by Mr. Strother] to defer consideration to the new year and that led to Mr. Knutson, and then later Mr. Cheikes, consulting Mr. Strother in 1998. [Emphasis added; paras. 32 and 96.]

Where a retainer has not been reduced to writing (as was the case with the 1998 retainer here) and no exclusions are agreed upon, as here, the scope of the retainer may be unclear. The court should not in such a case strain to resolve the ambiguities in favour of the lawyer over the client. The subject matter of the retainer here was, as it had been for years, "tax-assisted business opportunities". It was not to sell an office building, draft an informatics contract or perform other legal services unrelated to the subject matter of the earlier advice. The trial judge exonerated Strother by placing the emphasis on Monarch's interest in "alternative" tax opportunities, but of course Monarch only considered "alternative" tax opportunities because Strother had given categorical advice that the tax-assisted film production services business in which Strother had profitably been advising Monarch since 1993 was unequivocally dead.

41 I believe, as did the Court of Appeal, that the trial judge erred in drawing so narrowly the *legal* effect of his *factual* finding that the retainer dealt with tax-assisted business opportunities, alternative or otherwise. (In fact Strother's position is that what he pursued on behalf of Sentinel in 1998 *was* an alternative tax-assisted business opportunity and not the same TAPSF scheme as he had pronounced dead in 1997.) Monarch was a major Davis client of long standing. It had been Strother's biggest source of billings for years. It was in the business of marketing tax schemes whose success turned on Strother's expertise in finding a "way [to get] around the rules" (to borrow a phrase from Cheikes (BCCA #1, at para. 14). Strother's factum emphasizes nice distinctions between tax credits, tax shelters and so on (para. 24) but I do not think this oral retainer can or ought to be parsed so closely.

42 Nor can I agree with the Chief Justice when she characterizes the legal obligation arising out of the 1998 retainer as follows:

> Only if Monarch had specifically asked Strother for advice on new film tax-shelter opportunities and Strother had agreed to give that advice, could Strother have been under any duty to provide Monarch with such advice, placing him in a conflict of interest with Sentinel Hill. [para. 145]

Monarch's tax business was in a jam. Strother was still its tax lawyer. There was a continuing "relationship of trust and confidence". Monarch was dealing with professional advisors, not used car

salesmen or pawnbrokers whom the public may expect to operate on the basis of "didn't ask, didn't tell", and who collectively suffer a corresponding deficit in trust and confidence. Therein lies one of the differences between a profession and some businesses.

43 In my view, subject to confidentiality considerations for other clients, if Strother knew there was still a way to continue to syndicate U.S. studio film production expenses to Canadian investors on a tax-efficient basis, the 1998 retainer entitled Monarch to be told that Strother's previous negative advice was now subject to reconsideration.

44 It is this contractual duty that came into conflict with Strother's personal financial interest when he took a major stake in Sentinel which was, as Newbury J.A. pointed out, a competitor in a small market where experience showed that, even limited, competition could lead to a rapid erosion of market share.

B. *Breach of the 1998 Retainer*

45 The trial judgment, as stated, was premised on the finding that Monarch did not specifically ask about the possible revival of TAPSF-type shelters in 1998. I agree with the trial judge that *generally* a lawyer does not have a duty to alter a past opinion in light of a subsequent change of circumstances. This was discussed by W. M. Estey in *Legal Opinions in Commercial Transactions* (2nd ed. 1997), at p. 519:

> Thus, where an opinion was correct on the date on which it was given but subsequently becomes erroneous due to a change in the law or in the facts upon which the opinion was based, the opining lawyer is not liable for failing to warn the addressee, at the later date, of the effects resulting from the changed circumstances.

The rationale behind the general rule is that a legal opinion speaks as of its date, and that being the case, a lawyer is only obligated to exercise due care in rendering an opinion based on the legal and factual circumstances existing at that time. A client cannot assume that the lawyer's opinion has an indefinite shelf life.

46 There are, however, exceptions to the general rule. As Deschamps J. stated in *Côté v. Rancourt*, [2004] 3 S.C.R. 248, 2004 SCC 58, the "boundaries of [a lawyer's] duty to advise will depend on the circumstances" (para. 6). The issue here was not so much a duty to alter a past opinion, as it was part of Strother's duty to provide candid advice on all matters relevant to the *1998* retainer: *Neil*, at para. 19. It appears that Lowry J. turned his mind to this exception to the general rule when he stated that a lawyer is not obligated to "alter advice given under a *concluded* retainer" (para. 121 (emphasis added)). Here Monarch's retainer of Davis was *not* a concluded retainer. The written 1997 retainer had come to an end but the solicitor-client relationship based on a continuing (if more limited) retainer carried on into 1998 and 1999. As Deschamps J. further observed in *Côté*, "the obligational content of the lawyer-client relationship is not necessarily circumscribed by the

object of the mandate" (para. 6). The *Côté* approach is not consistent with the "didn't ask, didn't tell" approach taken by the trial judge. Strother was meeting with Monarch to brainstorm tax schemes and knew perfectly well Monarch would be vitally interested in Strother's re-evaluation of the tax potential of the MER. The duty to advise Monarch required Strother and Davis, as a term of the 1998 retainer, if not expressed (as claimed by Monarch) then certainly implied, to explain to Monarch that Strother's earlier advice had been overtaken by events and would have to be revisited. Indeed, Strother discussed this concern with another partner at Davis, Rowland K. McLeod who testified in cross-examination as follows:

> A. I did consider whether or not Monarch could be told and I guess that would include should be told ... And my recollection is that Mr. Strother came to me before a meeting that he was going to have with Mr. Knutson [a principal of Monarch] and we discussed and considered whether or not Monarch could be told [that the previous advice about "no fix" had been premature], and my, my recollection was that we didn't reach a consensus on what could be done and he was going to play it by ear ... . He was afraid Mr. Knutson was going to ask him.
> Q. When was that?
> A. It was in, I think it was June of 1998 ... We discussed it, came to no conclusion. He went to the meeting, told me either later that day or the next day, that the issue had not arisen. [Emphasis added.]
>
> (Davis's A.R., at p. 196)

McLeod continued:

> A. The nature of the, the, the nature of the discussion was, he was going to meet with Monarch. He was concerned that Mr. Knutson would raise the question of is there a way around the, whatever the change in the law was. [Emphasis added.] (Davis's A.R., at p. 198)

The fact that Strother and McLeod discussed what should be said if Monarch put the right question ("is there a way around ...?") recognized that Strother appreciated that his modified view about the potential of the s. 18.1(15)(*b*) exception would likely be of continuing interest and importance to Monarch because Monarch was still looking to him for advice in rebuilding its shattered tax-related business. At that point, of course, Strother had every interest in keeping Monarch in the dark. In June of 1998, under the January 1998 agreement, he was entitled to 55 percent of the first $2 million in profits and 50 percent of Sentinel's profits on the revival of tax-assisted film production services deals, which constituted a small and select marketplace. The fewer competitors faced by Sentinel the more money Strother would make and the faster he would pocket it.

47 Of course, it was not open to Strother to share with Monarch any *confidential* information received from Darc. He could nevertheless have advised Monarch that his earlier view was too

emphatic, that there may yet be life in a modified form of syndicating film production services expenses for tax benefits, but that because his change of view was based at least in part on information confidential to another client on a transaction unrelated to Monarch, he could not advise further except to suggest that Monarch consult another law firm. Moreover, there is no excuse at all for Strother not advising Monarch of the successful tax ruling when it was made public in October 1998. As it turned out, Monarch did not find out about it until February or March 1999. I therefore conclude that Davis (and Strother) failed to provide candid and proper legal advice in breach of the 1998 retainer.

48 If this were a contract case, I would have had no hesitation in holding both Davis and Strother liable for their failure to provide the timely and candid advice they were contractually obliged to give within the scope of their 1998 retainer. However, Monarch cannot succeed in a claim for damages for breach of the contract of retainer because (as found by the trial judge) it did not establish any damages flowing from the alleged breach. The issue therefore moves to fiduciary duties.

C. *Monarch's Claim for Disgorgement*

49 Monarch's claim is not for the money Monarch itself might have made had Strother given different advice (which the trial judge found was unsupported by the evidence), but for disgorgement by Strother, Darc, Sentinel and Davis of the money they *did* make between 1998 and 2001, which Monarch says was made in breach of Strother's and Davis's fiduciary obligations to it.

50 An accounting of profits and disgorgement are equitable remedies and relate to Monarch's claim that Strother, Darc and Davis breached their fiduciary obligations in the following respects:

(1) Davis should have declined to take on Darc and Sentinel as clients. Every dollar earned in consequence of that retainer was therefore in breach of fiduciary duty.
(2) Strother should not have accepted a personal financial interest in Sentinel. He should not benefit from this conflict of interest, and should therefore disgorge consequential profits.

In my view, only the claim related to Strother's personal financial interest has merit. It was that personal interest that came into conflict with Strother's fiduciary duty to avoid conflicts of interest in performing the contractual obligations assumed under the 1998 retainer.

1. <u>Davis was Free to Take on Darc and Sentinel as New Clients</u>

51 Monarch claims (and the Court of Appeal agreed) that even after the expiry of the "exclusive" retainer in 1997, Davis was conflicted out of acting for Darc and Sentinel by reason of its ongoing solicitor-client relationship with Monarch. As the House of Lords recently noted in relation to conflicting *contractual* duties, "a solicitor who has conflicting duties to two clients may not prefer one to another... . the fact that he [the lawyer] has chosen to put himself in an impossible position

does not exonerate him from liability" (*Hilton*, at para. 44). The same principle applies to a lawyer getting into a position of conflicting *fiduciary* duties. As Monarch's fiduciary, Strother's duty was to "avoid situations where he has, or potentially may, develop a conflict": *Ramrakha v. Zinner* (1994), 157 A.R. 279 (C.A.), at para. 73, as cited in *Neil*, at para. 25. The general rule is of long standing but I do not think it applied here to prevent Davis and Strother from acting for Sentinel. As stated in *Neil*, at para. 15:

> ... An unnecessary expansion of the duty may be as inimical to the proper functioning of the legal system as would its attenuation. The issue is always to determine what rules are sensible and necessary and how best to achieve an appropriate balance among the competing interests.

This is not to say that in *Neil* the Court advocated the resolution of conflict issues on a case-by-case basis through a general balancing of interests, the outcome of which would be difficult to predict in advance. In *MacDonald Estate v. Martin*, similarly, the legal rule was arrived at after balancing various interests, including trading off a client's ability to choose counsel against other considerations such as lawyer mobility. Once arrived at, however, the *MacDonald Estate v. Martin* rule protecting against disclosure of confidential information is applied as a "bright line" rule. The client's right to confidentiality trumps the lawyer's desire for mobility. So it is with *Neil*. The "bright line" rule is the product of the balancing of interests not the gateway to further internal balancing. In *Neil*, the Court stated (at para. 29):

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

52 I agree with Strother's counsel when he writes that "[t]he retainer by Sentinel Hill was not 'directly adverse' to any 'immediate interest' of Monarch". On the contrary, as Strother argues, "Sentinel Hill created a business opportunity which Monarch could have sought to exploit" (Strother factum, at para. 66). A Sentinel ruling that revived the TAPSF business even in modified form would indirectly help any firm whose tax syndication business had been ruined by the ITA amendments, including Monarch. Representation of Sentinel was thus not "directly adverse" to representation of Monarch by Davis/Strother even though both mandates related to tax-assisted business opportunities in the film production services field. Strother's problem arose because despite his duty to an existing client, Monarch, he acquired a major personal financial interest (unknown to Davis) in another client, Sentinel, in circumstances where his prospects of personal profit were enhanced by keeping Monarch on the sidelines. In deference to the conclusion reached by the British Columbia Court of Appeal that Davis was *not* free to take on Darc and Sentinel as clients, however, I add the following observations.

(a) *Monarch Was a Current Client*

53 I agree with Newbury J.A. that too much was made in argument about the shift from the 1997 written retainer to the 1998 oral retainer. The trial judge in places referred to a *concluded* retainer. However, this is not a case where *a former* client alleges breach of the duty of loyalty, as in *Stewart v. Canadian Broadcasting Corp.* (1997), 150 D.L.R. (4th) 24 (Ont. Ct. (Gen. Div.)); *Credit Suisse First Boston Canada Inc., Re* (2004), 2 B.L.R. (4th) 109 (O.S.C.); and *Chiefs of Ontario v. Ontario* (2003), 63 O.R. (3d) 335 (S.C.J.). The issue of loyalty to a former client was dealt with in *MacDonald Estate v. Martin* (not *Neil*), and raises complex issues not relevant here. Monarch was a *current* client and was unquestionably entitled to the continuing loyalty of Strother and Davis.

(b) *Acting for Clients with Competing Commercial Interests*

54 As recognized by both the trial judge and Newbury J.A., the conflict of interest principles do not generally preclude a law firm or lawyer from acting concurrently for different clients who are in the same line of business, or who compete with each other for business. There was no *legal* dispute between Monarch and Sentinel. Monarch relies on the "bright line" rule set out in *Neil* but (leaving aside, for the moment, Strother's personal financial stake) there is no convincing case for its application here.

55 The clients' respective "interests" that require the protection of the duty of loyalty have to do with the practice of law, not commercial prosperity. Here the alleged "adversity" between concurrent clients related to business matters. This is not to say that commercial interests can *never* be relevant. The *American Restatement* offers the example of two business competitors who seek to retain a single law firm in respect of competing applications for a single broadcast licence, i.e. a unique opportunity. The *Restatement* suggests that acting for both without disclosure and consent would be improper because the subject matter of both retainers is the same licence (*Restatement (Third) of the Law Governing Lawyers*, vol. 2, at S 121 (2000)). The lawyer's ability to provide even-handed representation is put in issue. However, commercial conflicts between clients that do *not* impair a lawyer's ability to properly represent the legal interests of both clients will not generally present a conflict problem. Whether or not a real risk of impairment exists will be a question of fact. In my judgment, the risk did not exist here provided the necessary even-handed representation had not been skewed by Strother's personal undisclosed financial interest. Condominium lawyers act with undiminished vigour for numerous entrepreneurs competing in the same housing market; oil and gas lawyers advise without hesitation exploration firms competing in the oil patch, provided, of course, that information confidential to a particular client is kept confidential. There is no reason in general why a tax practitioner such as Strother should not take on different clients syndicating tax schemes to the same investor community, notwithstanding the restricted market for these services in a business in which Sentinel and Monarch competed. In fact, in the case of some areas of high specialization, or in small communities or other situations of scarce legal resources, clients may be taken to have consented to a degree of overlapping representation inherent in such law practices, depending on the evidence: *Bolkiah v. KPMG*, [1999]

2 A.C. 222 (H.L.), at p. 235; *Kelly v. Cooper*, [1993] A.C. 205 (H.L.). The more sophisticated the client, the more readily the inference of implied consent may be drawn. The thing the lawyer must *not* do is keep the client in the dark about matters he or she knows to be relevant to the retainer: *Neil*, at para. 19. As Stoney J. commented almost two centuries ago:

> No man can be supposed to be indifferent to the knowledge of facts, which work directly on his interests, or bear on the freedom of his choice of counsel. When a client employs an attorney, he has a right to presume, if the latter be silent on the point, that he has no engagements, which interfere, in any degree, with his exclusive devotion to the cause confided to him; that he has no interest, which may betray his judgment, or endanger his fidelity.
>
> (*Williams v. Reed*, 29 F. Cas. 1386 (1824))

The client cannot be taken to have consented to conflicts of which it is ignorant. The prudent practice for the lawyer is to obtain informed consent.

(c) *The Duty of Loyalty is Concerned with Client Representation*

56 While the duty of loyalty is focussed on the lawyer's ability to provide proper client representation, it is not fully exhausted by the obligation to avoid conflicts of interest with other concurrent clients. A "conflict of interest" was defined in *Neil* as an interest that gives rise to a

> substantial risk that the lawyer's representation of the client would be materially and adversely affected by the lawyer's own interests or by the lawyer's duties to another current client, a former client, or a third person.
>
> (*Neil*, at para. 31, adopting **S** 121 of the *Restatement (Third) of the Law Governing Lawyers*, vol. 2, at pp. 244-45)

57 In *Hilton*, relied on by Davis, failure to disclose to one client prejudicial (but not confidential) information about the other client in a case where the defendant law firm acted for both clients in a joint venture was held to be actionable in contract although the quality of the legal work, as such, was not the subject of criticism. The House of Lords awarded damages as a matter of contract law, but *Martin v. Goldfarb* (1998), 41 O.R. (3d) 161 (C.A.) suggests that in this country such a claim could also be brought for breach of fiduciary duty even in the absence of a client-to-client conflict. In that case, an Ontario lawyer was held liable in damages to a client for breach of his fiduciary duty of candour to disclose his knowledge that the client's business adviser had a criminal record.

58 Exceptional cases should not obscure the primary function of the "bright line" rule, however, which has to do with the lawyer's duty to avoid conflicts that impair the respective representation of

the interest of his or her concurrent clients whether in litigation or in other matters, e.g. *Waxman v. Waxman* (2004), 186 O.A.C. 201 (C.A.).

(d) *The Impact on the Representation of Monarch Was "Material and Adverse*"

59 The spectre is flourished of long-dormant files mouldering away in a lawyer's filing cabinet that are suddenly brought to life for purposes of enabling a strategically minded client to assert a conflict for tactical reasons. But a court is well able to withhold relief from a claim clearly brought for tactical reasons. Conflict between concurrent clients where no confidential information is at risk can be handled more flexibly than *MacDonald Estate v. Martin* situations because different options exist at the level of remedy, ranging from disqualification to lesser measures to protect the interest of the complaining client. In each case where no issue of confidential information arises, the court should evaluate whether there is a serious risk that the lawyer's ability to properly represent the complaining client may be adversely affected, and if so, what steps short of disqualification (if any) can be taken to provide an adequate remedy to avoid this result.

60 There is no doubt that at all material times there was a "current meaningful" solicitor-client relationship between Monarch and Davis/Strother to ground the duty of loyalty (see e.g. *Uniform Custom Countertops Inc. v. Royal Designer Tops Inc.*, [2004] O.J. No. 3090 (QL) (S.C.J.), at para. 54). The availability of Strother's ongoing tax advice was important to Monarch and is the cornerstone of its claim.

61 Strother is dismissive of the impact his breach had on Monarch's interest (i.e. in obtaining proper legal advice). He is correct that the test requires that the impact must be "material and adverse" (as set out in the definition of conflict adopted in *Neil*, previously cited). While it is sufficient to show a possibility (rather than a probability) of adverse impact, the possibility must be more than speculation (see *de Guzman v. de la Cruz*, [2004] B.C.J. No. 72 (QL), 2004 BCSC 36, at para. 27). That test is met here, for the reasons already discussed. Once the existence of Strother's personal financial interest in Sentinel was established, it was for Strother, not Monarch, to demonstrate the absence of any material adverse effect on Monarch's interest in receiving proper and timely legal advice (*Celanese Canada Inc. v. Murray Demolition Corp.*, [2006] 2 S.C.R. 189, 2006 SCC 36).

(e) *Sentinel's Desire to Secure the Counsel of its Choice Was Also an Important Consideration*

62 The evidence showed that Strother's special expertise was available from few other firms. Sentinel's Paul Darc had worked successfully with Davis and Strother for years. Our legal system, the complexity of which perhaps reaches its apex in the ITA, depends on people with legal needs obtaining access to what they think is the best legal advice they can get. Sentinel's ability to secure the advice of Davis and Strother as counsel of choice is an important consideration (*MacDonald Estate v. Martin*, at p. 1243; *R. v. Speid* (1983), 43 O.R. (2d) 596 (C.A.); and *Coutu v. Jorgensen* (2004), 202 B.C.A.C. 67, at para. 31; *Neil*, at para. 13). It does not trump the requirement to avoid

conflicts of interest but it is nevertheless an important consideration.

2. The Difficulty in Representing Monarch Arose from a Strother Conflict not a Davis Conflict

63 Davis did not appreciate what Strother was up to and had no reason to think the Sentinel retainer would interfere with the proper representation of Monarch.

64 The Court of Appeal upheld Monarch's claim that Strother/Davis was not free to take on Darc/Sentinel for the following reason:

> In this case, Mr. Strother should have told Mr. Darc that he "could not accept this business". His failure to do so meant that he could not be candid with his existing client, Monarch, regarding a subject on which he had given clear and unequivocal advice. He would have to "hold back" on what he would normally advise Monarch, in order to protect the confidentiality of his other client Mr. Darc (and the Sentinel Hill companies). [BCCA #1, at para. 25]

65 I believe, with respect, that this draws the prohibition too broadly. In general, Davis and Strother were free to take on Darc and Sentinel as new clients once the "exclusivity" arrangement with Monarch expired at the end of 1997. Issues of confidentiality are routinely dealt with successfully in law firms. Strother could have managed the relationship with the two clients as other specialist practitioners do, by being candid with their legal advice while protecting from disclosure the confidential details of the other client's business. If the two are so inextricably bound together that legal advice is impossible, then of course the duty to respect confidentiality prevails, but there is nothing here to justify Strother's artful silence. Strother accepted Sentinel as a new client and the Davis firm was given no reason to think that he and his colleagues could not provide proper legal advice to both clients.

3. Strother was not Free to Take a Personal Financial Interest in the Darc/Sentinel Venture

66 The trial judge found that Strother agreed to pursue the tax ruling on behalf of Sentinel in return for an interest in the profits that would be realized by Sentinel if the ruling was granted:

> ... Mr. Strother prepared the request for the ruling without charge in return for Mr. Darc's agreement that Mr. Strother would participate equally (55% on the first $2 million) [and 50% thereafter] in any profit realized through a share option should the desired ruling be granted. Responsibility for expenses associated with the request would be equally borne... .
>
> ...

> ... Mr. Strother agreed to seek for him an advance tax ruling and, as indicated, to prepare the request without charge, in return for an equal share in any success ultimately realized. [paras. 23 and 57]

67 Strother had *at least* an "option" interest in Sentinel from January 30th until at least August 1998 (when he was told by Davis to give up *any* interest). This was during a critical period when Monarch was looking to Strother for advice about what tax-assisted business opportunities were open. The precise nature of Strother's continuing financial interest in Sentinel between August 1998 and March 31, 1999 (when Strother left Davis) is unclear, but whatever it was it came to highly profitable fruition in the months that followed. The difficulty is not that Sentinel and Monarch were potential competitors. The difficulty is that Strother aligned his personal financial interest with the former's success. By acquiring a substantial and direct financial interest in one client (Sentinel) seeking to enter a very restricted market related to film production services in which another client (Monarch) previously had a major presence, Strother put his personal financial interest into conflict with his duty to Monarch. The conflict compromised Strother's duty to "zealously" represent Monarch's interest (*Neil*, at para. 19), a delinquency compounded by his lack of "candour" with Monarch "on matters relevant to the retainer" (*ibid.*), i.e. his own competing financial interest: *Nocton v. Lord Ashburton*, [1914] A.C. 932 (H.L.); *R. v. Shamray* (2005), 191 Man. R. (2d) 55, 2005 MBQB 1, at paras. 42-43; and *R. v. Henry* (1990), 61 C.C.C. (3d) 455 (Que. C.A.), at p. 465. See generally R. F. Devlin and V. Rees, "Beyond Conflicts of Interest to the Duty of Loyalty: from *Martin v. Gray* to *R. v. Neil*" (2005), 84 *Can. Bar Rev*. 433.

68 As we have seen, the tax-assisted film production services business was very competitive. Monarch's TAPSF market share had been cut by 80 percent when Grosvenor and other competitors entered the field. If his "fix" worked, Strother had every incentive to distance Monarch as a potential competitor to Sentinel. The bigger Sentinel's market share, the more business it did, the more assured would be the initial $2 million profit and the faster Strother would pocket it.

69 In these circumstances, taking a direct and significant interest in the potential profits of Monarch's "commercial competito[r]" (as described by Lowry J., at para. 113) created a substantial risk that his representation of Monarch would be materially and adversely affected by consideration of his own interests (*Neil*, at para. 31). As Newbury J.A. stated, "Strother ... *was* 'the competition'" (BCCA #1, at para. 29 (emphasis in original)). It gave Strother a reason to keep the principals of Monarch "in the dark" (*ibid.*), in breach of his duty to provide candid advice on his changing views of the potential for film production services tax shelters. I agree with Newbury J.A. that Monarch was "*entitled* to candid and complete advice from a lawyer who was not in a position of conflict" (*ibid.*, at para. 17 (emphasis in original)).

70 Strother could not with equal loyalty serve Monarch and pursue his own financial interest which stood in obvious conflict with Monarch making a quick re-entry into the tax-assisted film financing business. As stated in *Neil*, at para. 24, "[l]oyalty includes putting the client's business ahead of the lawyer's business". It is therefore my view that Strother's failure to revisit his 1997

advice in 1998 at a time when he had a personal, undisclosed financial interest in Sentinel Hill breached his duty of loyalty to Monarch. The duty was further breached when he did not advise Monarch of the successful tax ruling when it became public on October 6, 1998. Why would a rainmaker like Strother not make rain with as many clients (or potential clients) as possible when the opportunity presented itself (whether or not existing retainers required him to do so)? The unfortunate inference is that Strother did not tell Monarch because he did not think it was in his personal financial interest to do so.

4. Davis Did Not Participate in Strother's Disabling Conflict of Interest

71 As discussed, Strother did not advise Davis of his January 1998 deal with Darc until August 1998, and even then he did so inaccurately. On the basis of what Davis was told, Davis's managing partner instructed Strother not to exercise the "option" to acquire an interest in Sentinel. Whatever financial arrangement Strother had with Darc and Sentinel, Davis was not aware of it or a party to it.

72 The conversation between Strother and McLeod, mentioned earlier, is not sufficient to implicate either McLeod or the firm in that breach. Monarch claims that 28 of the same Davis lawyers and students that worked on Sentinel Hill in 1998-1999 had previously worked on Monarch from 1993-1997; and 11 lawyers worked on both Monarch and Sentinel in 1998. Moreover, Monarch points out that several partners and senior officers at Davis appear to have had some level of knowledge about Sentinel, such as McLeod (the "commercial partner in charge" (BCCA #2, at para. 6)), Mr. Elischer (Davis's managing director (BCCA #2, at para. 8)), and, by the summer of 1998, Mr. Buchanan (Davis's managing partner (BCCA #2, at para. 10)). However, there is no evidence that any of these people were aware of Strother's personal financial interest before August 1998, at which point it was forbidden.

73 Monarch's failure to establish knowledge on the part of other Davis partners of the circumstances giving rise to the conflict is crucial to an assessment of their potential liability as fiduciaries. The Davis firm was as much an innocent victim of Strother's financial conflict as was Monarch. However, though not party to Strother's breach of fiduciary duty, Davis may still be vicariously liable for Strother's "wrongful act" under s. 12 of the *Partnership Act*, as will be discussed.

D. *Fiduciary Remedies*

74 This Court has repeatedly stated that "[e]quitable remedies are always subject to the discretion of the court". See, e.g., *Wewaykum Indian Band v. Canada*, [2002] 4 S.C.R. 245, 2002 SCC 79, at para. 107; *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377, at p. 444; *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534, at pp. 587-89; and *Côté*, at paras. 9-14. In *Neil*, the Court stated emphatically: "It is one thing to demonstrate a breach of loyalty. It is quite another to arrive at an appropriate remedy" (para. 36).

75 Monarch seeks "disgorgement" of profit earned by Strother and Davis. Such a remedy may be directed to either or both of two equitable purposes. Firstly, is a *prophylactic* purpose, aptly described as appropriating

> for the benefit of the person to whom the fiduciary duty is owed any benefit or gain obtained or received by the fiduciary in circumstances where there existed a conflict of personal interest and fiduciary duty or a significant possibility of such conflict: the objective is to preclude the fiduciary from being swayed by considerations of personal interest.
>
> (*Chan v. Zacharia* (1984), 154 C.L.R. 178 (Aust. H.C.), *per* Deane J., at p. 198)

76 The second potential purpose is *restitutionary*, i.e. to restore to the beneficiary profit which properly belongs to the beneficiary, but which has been wrongly appropriated by the fiduciary in breach of its duty. This rationale is applicable, for example, to the wrongful acquisition by a fiduciary of assets that should have been acquired for a beneficiary, or wrongful exploitation by the defendant of the plaintiff's intellectual property. The restitutionary purpose is not at issue in the case of Strother's profit. The trial judge rejected Monarch's claim that Darc usurped a corporate opportunity belonging to Monarch (paras. 128, 179 187). This finding was upheld on appeal (para. 73).

77 The concept of the *prophylactic* purpose is well summarized in the Davis factum as follows:

> [W]here a conflict or significant possibility of conflict existed between the fiduciary's duty and his or her personal interest in the pursuit or receipt of such profits ... equity requires disgorgement of any profits received even where the beneficiary has suffered no loss because of the need to deter fiduciary faithlessness and preserve the integrity of the fiduciary relationship. [Emphasis omitted; para. 152.]

Where, as here, disgorgement is imposed to serve a prophylactic purpose, the relevant causation is the breach of a fiduciary duty and the defendant's gain (not the plaintiff's loss). Denying Strother profit generated by the financial interest that constituted his conflict teaches faithless fiduciaries that conflicts of interest do not pay. The *prophylactic* purpose thereby advances the policy of equity, even at the expense of a windfall to the wronged beneficiary.

1. Monarch's Claims

78 I proceed to consider the claims for disgorgement made by Monarch against Strother and Davis:

(a) All legal fees paid by Monarch since 1993;

(b) all legal fees paid by Darc and Sentinel to Davis;
(c) all profits earned by Strother.

I will address each in turn.

(a) *Legal Fees Paid by Monarch*

79 A causal relationship between the breach of fiduciary duty and the profits is required in order for an accounting to be ordered. Monarch paid approximately $85,000 to Davis in legal fees during 1998. Monarch's claim for the return of these fees rests on the proposition that Davis earned these profits in consequence of Strother's failure to advise Monarch properly or refer it elsewhere. The Court of Appeal ordered "that Davis must return to Monarch all fees (not including disbursements) paid by it from and after January 1, 1998" (BCCA #2, at para. 56).

80 Davis charged Monarch for general corporate services and "clean-up" work on prior transactions. This work was not tainted and I would not order a return of such fees charged to Monarch in 1998 or 1999. However, to the extent Strother personally made a profit under the Davis firm allocation process attributable to hours docketed to Monarch's account, or to fees paid to the firm by Monarch, such profit (earned at a time when Strother was in a position of conflict, and derelict in his duty to Monarch) should form part of Strother's accounting to Monarch.

81 As Davis committed no breach of fiduciary duty to Monarch, and is not responsible for Strother's breach as discussed below, there can be no order for equitable relief against Davis in this or other respects.

(b) *Legal Fees Paid by Sentinel to Davis*

82 The Court of Appeal ordered Davis to "account for and disgorge the profits it earned from acting for Sentinel in breach of its duty to Monarch from and after January 1, 1998" (BCCA #2, at para. 50). Newbury J.A. added:

> I am not persuaded there is any principled reason for a cut-off of such accounting as of the date Monarch withdrew from Davis's clientele ... in a very real sense, all the fees earned by the firm thereafter [late 1997 or early 1998] from Sentinel Hill were rooted in Mr. Strother's (and hence Davis's) preparation of the ruling request. For similar reasons, a cut-off date as of March 1999 when Mr. Strother left Davis must also be rejected, in my view: the foundation for the firm's substantial fees had been laid the previous year.

83 In my view, with respect, there was no *Neil*-type conflict *known to Davis* that prevented it from acting for both Sentinel and Monarch. The legal fees paid by Sentinel to Davis cannot therefore be said to be "in consequence" of breaches of fiduciary duties owed by Davis to Monarch. My conclusion on this point differs from that of the Court of Appeal because in my view it was not

a breach of fiduciary duty for Davis to take on Sentinel as a client. Profits earned by Davis on the fees paid by Sentinel were a result of Davis properly accepting the Sentinel retainer and Davis lawyers providing the legal services for which the fees were charged. The profits were produced by the skill and expertise of the lawyers at Davis who worked on the Sentinel files. The result well might be different had it been a breach for Davis and Strother to take on Sentinel as a client, but that issue does not arise here.

(c) *Profits Earned by Strother*

84 The expert's final report on the entitlement of Strother and Darc to financial benefits from Sentinel Hill established that the share for the two of them was $4,132,131 in 1998 and $22,818,028 in 1999.

85 Strother must account for profit earned from the personal financial opportunity he pursued in breach of his fiduciary duty to Monarch. Whatever form his ongoing relationship or understanding with Sentinel took after August 1998, he had sowed the seeds of Sentinel's success before that date and reaped his reward when the harvest ripened in 1999 and 2000. Sentinel advanced Strother almost $1 million in February and early March 1999. This was before Strother resigned from the Davis firm on March 31, 1999.

86 Strother characterizes these advances as "loans" which were set off against management fees that serendipitously became payable to Strother later that year. Monarch contends it was Strother's share of the profits earned on the transactions that Sentinel had closed. The fact is that Strother received $1 million. Even as a "loan" that was a significant benefit. The money was in fact never repaid. If the prophylactic purpose of the equitable remedy is to be achieved, Strother cannot be permitted to pocket the money thus derived from a personal interest in conflict with his fiduciary duty.

87 Once it is determined that Strother must disgorge profits related to his breaches of loyalty to Monarch, and is therefore subject to an accounting in that regard, it is also necessary to determine whether the period during which Strother should be obliged to account extends beyond the date when the tax ruling was made public (October 6, 1998). A further issue on remedy is Strother's request for an apportionment of whatever profits are awarded. His counsel points out, correctly, that "even where it is found that profits have been derived from a breach, they may nonetheless be apportioned ... depending on the extent to which the profits are attributable to the breach (Strother factum, at para. 132). I will deal first with the issue of a cut-off date and then return to the question of apportionment.

2. <u>The "Accounting Period" Defined</u>

88 The Court of Appeal, despite its observation that the accounting remedy itself should not become "an instrument of injustice" (BCCA #1, at para. 52), nevertheless concluded that the "accounting period" should be open-ended:

> After much anxious consideration, I have therefore concluded that Mr. Strother must be required to account for and disgorge to Monarch all benefits, profits, interests and advantages he has received <u>or which he may hereafter be entitled to receive, directly or indirectly</u> (i.e., through a corporation, trust, or other vehicle), from or through any of the Sentinel Hill Entities. [Emphasis added.]
>
> (BCCA #1, at para. 61, *per* Newbury J.A.)

An accounting of profits is an equitable remedy and, as La Forest J. noted in a different context:

> ... equity is not so rigid as to be susceptible to being used as a vehicle for punishing defendants with harsh damage awards out of all proportion to their actual behaviour.
>
> (*Hodgkinson v. Simms*, at p. 444)

89 To the same effect, the High Court of Australia noted in *Warman International Ltd. v. Dwyer* (1995), 128 A.L.R. 201, at pp. 211-12:

> ... the stringent rule requiring a fiduciary to account for profits can be carried to extremes and ... in cases outside the realm of specific assets, the liability of the fiduciary should not be transformed into a vehicle for the unjust enrichment of the plaintiff.

In *Warman* itself, the Court found that two years was the appropriate period for which defendants should be ordered to account. From the profits so determined, an allowance for the expenses, skill, expertise, effort and resources contributed by the defendants was to be deducted.

90 In my view, a "cut off" is appropriate in this case as well. At some point, intervention of other events and actors (as well as the behaviour of the claimant) dissipates the effect of the breach. A number of cut-off dates are suggested:

(i) the date the advance tax ruling was issued (October 6, 1998) plus a reasonable time for Monarch to put its house in order to pursue tax-assisted film production services opportunities;
(ii) the date Monarch actually learned of the tax ruling (February or early March 1999) plus time to put its house in order, etc.;
(iii) the date Monarch fired Davis (on or about March 8, 1999, when Monarch sent a claim letter to Davis;
(iv) the date Sherman and other participants in the Sentinel group transformed

Darc's original structure into its eventual highly profitable form in the late spring of 1999;

(v) the date Strother left Davis and ceased to have a solicitor-client relationship with Monarch (March 31, 1999);

(vi) the date Monarch ceased serious efforts to get back into the tax-assisted film production services business in September 1999.

91 By failing to advise Monarch, or at the very least to refer it elsewhere in the spring of 1998, Strother pursued his own interest and denied Monarch the timely opportunity to find new counsel and advance the possibility of reviving in modified form its tax-assisted film production services business. Further, in October 1998, Strother failed to advise his client of the tax ruling when it was made public. Strother denies that Monarch would have benefited from the opportunity even if it had been offered in a timely way, but the evidence is that Monarch *did* try to get back into the tax-assisted film business through another law firm once it found out about the Sentinel ruling, as noted by the trial judge (paras. 33 and 182). By September 1999, Monarch's new tax counsel, Allan Beach, had prepared a structure that could have been used to obtain a tax ruling. However, the trial judge found that after September 1999, Monarch did not proceed with serious diligence (para. 182). By that time, of course, Strother had long since left the Davis firm (March 1999) thus terminating the conflict.

92 I now propose to consider which of the options represents the most appropriate cut off.

93 The advance tax ruling became public shortly after it was issued on October 6, 1998. Counsel to Monarch's former competitors seized upon it, advised their clients, and began developing structures to re-enter the market. However, Strother was counsel to Monarch and said nothing. As the evidence indicated, the silence was deliberate at a time when his financial interests were now aligned with Sentinel. In the absence of that conflict it is difficult to believe that Strother, as an experienced and successful rainmaker for the Davis firm, would not have picked up the telephone and called Monarch to give them the good news and correct the earlier negative advice he had provided. At least by the time the ruling became public, whatever the duty of confidentiality Strother believed he owed to Sentinel in relation to the prospective ruling had disappeared.

94 Bradley Sherman became a consultant to Sentinel in February 1999. The trial judge found that Sentinel would not have been as successful as it became without his innovations. At some point, profits earned by Strother were attributable in substantial part to Sherman's business acumen and Sentinel's later affiliation with Alliance. Disgorgement of that money to Monarch would be punitive, not prophylactic.

95 In my view, the prophylactic purpose would be served if Strother is required to account to Monarch for all monies (including the $1 million "loan" which should be treated as monies beneficially received by Strother on the date "loaned") received during or attributable to his period with Davis between January 1, 1998 and March 31, 1999. At that point, both Monarch and Strother

had severed their links with Davis. The conflict was spent.

3. Should Strother's Profit be Apportioned ?

96 In my view, this is not a case for apportionment. The Court's purpose here is prophylactic rather than restitutionary. We are not therefore engaged in allocating an amount of profit amongst different contributing sources (or "profit drivers"). Strother acquired a personal financial interest in one client that conflicted with his duty to provide full and candid advice to another concurrent client. He should not be permitted to profit from that conflicting interest even though it is justly said that his own skill and experience were major contributors to those profits. Apportionment in these circumstances would reward the breach and undermine achievement of the *prophylactic* purpose.

4. Strother May Be Entitled to Reasonable Deductions

97 Monarch is awarded, within the limits stated above, "profits". From whatever portion of profit is awarded to Monarch should be deducted, if established, Strother's reasonable and necessary expenses incurred by him to earn the profit: *MacMillan Bloedel Ltd. v. Binstead* (1983), 22 B.L.R. 255 (B.C.S.C.), at p. 294. The parties have agreed that such deductions are to be determined in a post-trial reference.

5. Is Davis Liable for Strother's Fiduciary Breach and if so to What Extent?

98 I have already concluded that Davis did not breach its fiduciary duty to Monarch. The Davis partners were innocent of Strother's breach. The firm cannot be held to have breached a fiduciary duty on the basis of facts of which its partners were ignorant. Nevertheless, Monarch claims that Davis is vicariously liable for Strother's personal profits. This aspect of the claim was rejected by the Court of Appeal on the basis that Strother was on a "frolic of his own" (BCCA #2, at para. 42). Newbury J.A. concluded that:

> ... the partners of Davis were not shown to have known of, or to have been wilfully blind to, or reckless regarding, Mr. Strother's taking an interest in Sentinel Hill. When Mr. Strother informed his firm of a supposed option, the managing partner clearly forbade his having *any* interest, and he appeared to accept that direction. Whilst in hindsight it might be said the firm should have been alerted to the possibility that Mr. Strother would nevertheless proceed to take (or retain) an interest, the authorities are clear that the test is not an objective one. [Emphasis in original; BCCA #2, at para. 63]

99 I agree that not only was Davis unaware of Strother's financial interest but Davis had no reason to think that Strother had failed to comply with the managing partner's direction not to take an interest in Sentinel. Nevertheless, Monarch contends that even in the absence of direct fault on the part of Davis and its partners, it is entitled to a statutory recovery under the following provisions of the B.C. *Partnership Act*:

> **11** A partner in a firm is liable jointly with the other partners for all debts and obligations of the firm incurred while he or she is a partner, and after his or her death his or her estate is also severally liable in a due course of administration for those debts and obligations, so far as they remain unsatisfied, but subject to the prior payment of his or her separate debts.
>
> **12** If, by any wrongful act or omission of any partner acting in the ordinary course of the business of the firm or with the authority of his or her partners, loss or injury is caused to any person who is not a partner in the firm or any penalty is incurred, the firm is liable for that loss, injury or penalty to the same extent as the partner so acting or omitting to act.
>
> ...
>
> **14** A partner is jointly and severally liable with his or her partners for everything for which the firm, while he or she is a partner in it, becomes liable under either section 12 or 13.

Monarch's claim in this respect extends both to Strother's profit under his arrangement with Darc/Sentinel as well as Strother's share of the Davis profits from billings to Monarch. The claim is purely statutory.

100 The words "wrongful act or omission" in s. 12 are broad enough to embrace an equitable wrong. There is nothing in the language of s. 12 to confine vicarious liability to common law torts: *McDonic Estate v. Hetherington (Litigation Guardian of)* (1997), 31 O.R. (3d) 577 (C.A.), at p. 580; *Dubai Aluminium Co. v. Salaam*, [2003] 2 A.C. 366 (H.L.), at p. 375.

101 The legislature has imposed liability where "loss or injury is caused" (emphasis added). The trial judge found that Monarch had not proven that Strother's breaches of fiduciary duty had caused it financial loss, but Monarch certainly suffered *injury* by being denied the legal advice to which it was entitled, and the compensation at issue was awarded in relation to that injury. Section 12 differentiates between a "loss" and an "injury". The legislature has said that a "loss" is not necessary to ground recovery under s. 12. An injury without loss is sufficient.

102 What then is the nature and extent of the innocent partners' liability? The firm is liable "for that loss, injury or penalty". The inclusion of a "penalty" in s. 12 indicates that even statutory impositions are included (*Dubai Aluminium*, at para. 103). The combination of "loss, injury or penalty" suggests that the legislative purpose is to ensure that a delinquent partner's liability incurred "to any person who is not a partner", with the firm's authority or in the ordinary course of the firm's business, is to be treated as the obligation of the firm regardless of its legal origin. A money judgment resulting from an accounting of profits against the delinquent partner comes within

this description, in my opinion.

103 Davis argues that where a partner's fault has not occasioned economic loss to the client, and the accounting of profit is imposed for *prophylactic* rather than restitutionary purposes, vicarious liability serves no useful purpose. Davis argues:

> The rule is intended to deter and not to punish. It seeks to deter fiduciaries from breach of their duty by making them aware that they cannot retain any profit made thereby, thus removing any incentive to disloyalty. That purpose can be achieved only when the fiduciary [i.e., the other partners] is sufficiently knowledgeable of the facts on which breach of duty is alleged to realize that a breach has occurred, or may occur. [Davis factum, at para. 154.]

This argument is persuasive as a matter of equity but at this point Monarch is demanding a *statutory* remedy. Nowhere in s. 12 is it suggested that prior knowledge of the delinquency by the other partners is a condition precedent to liability. On the contrary, proof of prior knowledge by the partners would raise questions of direct liability and, if found, would render unnecessary resort to vicarious liability under s. 12 of the *Partnership Act*. It is in the nature of vicarious liability under s. 12 that the firm may be innocent of any fault other than the misfortune of having on board a rogue partner at the time of his or her delinquency.

104 Monarch must still show that Strother acted "with the authority of his or her partners" *or* "in the ordinary course of the business of the firm" (s. 12).

105 Clearly, Strother did not act "with the authority" of his partners. The more difficult question is whether it can be said that Strother's wrongful act was "in the ordinary course of the business" of Davis. The Court of Appeal held that it was not, but I do not think that such a conclusion is consistent with the now well-established principles of vicarious liability established in *Bazley v. Curry*, [1999] 2 S.C.R. 534, and applied in cases such as *Jacobi v. Griffiths*, [1999] 2 S.C.R. 570; *E.D.G. v. Hammer*, [2003] 2 S.C.R. 459, 2003 SCC 52; *K.L.B. v. British Columbia*, [2003] 2 S.C.R. 403, 2003 SCC 51; *Blackwater v. Plint*, [2005] 3 S.C.R. 3, 2005 SCC 58, and *E.B. v. Order of the Oblates of Mary Immaculate in the Province of British Columbia*, [2005] 3 S.C.R. 45, 2005 SCC 60. In *Dubai Aluminium*, the House of Lords, at para. 23, referred with approval to the principles of vicarious liability set out by McLachlin J. in *Bazley* as an aid to the interpretation of the English equivalent of s. 12. These principles were summarized by McLachlin J. (as she then was) in *Bazley*, at paras. 37 and 41, as follows:

> ... the policy purposes underlying the imposition of vicarious liability on employers are served only where the wrong is so connected with the employment that it can be said that the employer has introduced the risk of the wrong (and is thereby fairly and usefully charged with its management and minimization).
>
> ...

> ...Vicarious liability is generally appropriate where there is a significant connection between the *creation or enhancement of a risk* and the wrong that accrues therefrom, even if unrelated to the employer's desires. Where this is so, vicarious liability will serve the policy considerations of provision of an adequate and just remedy and deterrence. [Emphasis in original.]

Section 12 of the *Partnership Act* should be interpreted in a manner consistent with these principles. The "ordinary course of the business" test thus requires Strother's wrong to be "so connected" with the partnership business that it can be said that Davis introduced the risk of the wrong that befell its client Monarch and is thereby fairly and usefully charged "with its management and minimization".

106 While, of course, the Court of Appeal is correct that acceptance of personal financial benefits by a rogue partner was not in the ordinary course of the business of Davis, the fact is that the wrongful act in this case was "so connected" with Davis's ordinary business that it led to a contractual breach of Monarch's retainer of Davis. *Both* Monarch and Sentinel retained Davis to provide professional services. Darc did not approach Strother in January 1998 to do a little frolic on the side. The January 30, 1998 memo between Darc and Strother called for the provision by the Davis firm of legal services, e.g.:

> Davis & Company will form two limited partnerships and two corporations as the initial entities which will be used in the structure... .
>
> Davis & Company will apply for an advance income tax ruling, the application for which will be supported by draft agreements, reviewed by you and the participating film or television studio (likely a Viacom entity)... .
>
> If we are successful in obtaining an advance income tax ruling from Revenue Canada, we will retain Davis & Company to prepare and file an offering memorandum and prepare relevant transaction documents to effect a syndication offering to implement the transactions described in the ruling ... [A.R., at pp. 888-89]

107 As to Monarch, the provision of timely and candid legal advice was the essence of the retainer. Davis's failure to perform this retainer properly is explicable, as Newbury J.A. found, by Strother's decision to keep Monarch "in the dark", which resulted from his conflicting personal financial interest. It is not possible, in my view, to disentangle Strother's wrongful act from the "ordinary business" of Davis so as to hold that Strother was off "on a frolic of his own". In these circumstances the "twin objectives" of compensation of the wronged client and deterrence of faithless fiduciaries will generally be furthered by vicarious liability, e.g., by encouraging greater vigilance by other partners, even though in some cases (as here) it may be difficult to know what more the other partners ought to have done to keep Strother out of trouble.

108 If Davis is called on to pay monies to Monarch on the basis of vicarious liability, Davis will no doubt seek to claim indemnity from Strother. If, in the circumstances, the claim is allowed and the rogue partner can pay, the firm is protected. If the rogue partner cannot pay, the legislature has decided that there is no good reason why the loss or injury should be inflicted on the innocent client rather than on the partnership which put the rogue partner in a professional position to do what he or she did.

6. Abuse of Monarch's Confidential Information

109 It is common ground that while Davis and Strother were free to put their legal skills at the service of their other clients, they could not in doing so make use of information provided in confidence by Monarch (or, for that matter, Sentinel).

110 The Court of Appeal agreed with the trial judge that "no real element of confidentiality had been proven by Monarch as inherent in the transactional documents created by Davis for Monarch and that Monarch had not succeeded in establishing a breach of confidence 'based on similarity of documentation alone'" (BCCA #2, at para. 62). However, it did conclude with respect to Monarch's "production services deal memo", (or as it was later called, the "Production Services Agreement") that

> some of the clauses in the Sentinel Hill documents are almost identical. In respect of this document as well, the evidence seems clear that it originated with Mr. Cheikes, as Mr. Darc admitted using the "Production Services Agreement" to create Monarch documents before leaving that company's employ. [BCCA #2, at para. 60]

111 The Court of Appeal went on to conclude that "the production services deal memorandum of Sentinel Hill had its genesis in the 'Cheikes package' of documents" (BCCA #2, at para. 61). In my view, with respect, it is not enough to show that a particular transaction document has its "genesis" in a prior transaction document. Recycling precedents is the life-blood of corporate law practice. A document prepared for Client A is part of the lawyer's work product and may go through numerous iterations in the service of other clients. The practice of law would be hopelessly inefficient and costly for clients if transactional documents had to be reinvented rather than customized. Provided confidential information is not employed, it seems to me that Monarch cannot complain on this account. I would not give Monarch relief on the basis of the genesis of a document where the successor document does not itself disclose confidential information of the claimant contained in the earlier document.

E. *Monarch's Cross-Appeal Against Paul Darc*

112 I would dismiss Monarch's claim against Darc for the reasons given by Newbury J.A.

V. Disposition

113 I would dismiss the Strother appeals against the finding that, in 1998, Strother put himself in a position of conflict between his duty to Monarch and his personal financial interest. To further this interest, he failed to provide Monarch in 1998 with the legal advice to which Monarch was entitled. With respect to remedy, the Strother appeals are allowed in part. Strother must account to Monarch for the personal profit gained directly from the Sentinel group and indirectly through his earnings as a Davis partner on account of billings to Monarch, but only for the period January 1, 1998 to March 31, 1999. As agreed by the parties, a reference is directed to determine the appropriate calculation of Strother's profit. Monarch is to have a money judgment against Strother in the sum thus ascertained.

114 The appeal by Davis against the decision of the Court of Appeal is allowed in part. Davis committed no breach of fiduciary duty to Monarch and is not liable for Strother's breaches of fiduciary duty, of which its partners are innocent, except under the terms of s. 12 of the *Partnership Act*. The liability of Davis is limited to vicarious liability for the sum found to be due by Strother to Monarch under the preceding paragraph.

115 Monarch's cross-appeal is dismissed with costs.

116 Except as aforesaid, all parties and the intervener will bear their own costs in light of the divided success.

The reasons of McLachlin C.J. and Bastarache, LeBel and Abella JJ. were delivered by

McLACHLIN C.J.:--

I. Introduction

117 It is fundamental to the practice of law that a lawyer acts for many clients. It is equally basic that specialized lawyers act for many clients in the same line of business, some of whom may be competitors. Lawyers and law firms are permitted to act for multiple clients in the same line of business, provided they avoid conflicts of interest.

118 The issue before us is whether, on the facts of this case, a conflict arose. Justice Binnie concludes that it did, and holds as a consequence that the lawyer, Mr. Robert C. Strother, must pay to his first client, Monarch, a significant portion of the money he earned with the second client. I respectfully disagree. In my view, whether a conflict between two clients exists is dependent on the scope of the retainer between the lawyer and the client in question. The fiduciary duties owed by the lawyer are molded by this retainer, as they must be in a world where lawyers represent more than one client.

119 The trial judge made clear findings of fact as to the limited scope of the retainer between Davis and Monarch ((2002), 26 B.L.R. (3d) 235, 2002 BCSC 1179, at paras. 10 and 106-8), and on

this basis concluded that no conflict arose when Strother took on a second client in the same line of business. It is not open to this Court to revisit the trial judge's findings, absent a palpable and overriding error. There are no such errors. Nor is it open to us to superimpose a broad fiduciary obligation independent of and inconsistent with the retainer. It follows that the trial judge's conclusion that no conflict arose should be upheld and Strother's appeals allowed. I would dismiss the cross-appeal.

II. Background

120 The *Income Tax Act*, R.S.C. 1985, c.1 (5th Supp.), in the 1990s permitted tax-sheltered investments in Canadian-made films. Monarch established a business putting together film makers and investors who wished to take advantage of such tax shelters. Strother, a tax lawyer in the firm Davis & Company, a partnership (also referred to as "Davis"), acted as Monarch's lawyer in connection with this business; indeed, in the mid-90s Monarch was Strother's biggest client.

121 Effective October 1997, the government ended the tax-shelter scheme by introducing new Matchable Expenditures Rules. Strother advised Monarch that he saw no way to get around these rules. He had no technical fix, and even if he could devise one, he did not consider that any advance tax ruling could be obtained, given the new rules. This advice was consistent with advice being given by other tax lawyers to other clients at the time. The trial judge found that the advice Strother gave Monarch at the end of 1997 was correct at the time and that Strother "concealed nothing from Monarch in 1997 in order to take a benefit for himself" (para. 91).

122 Monarch wound down its business. Its exclusive written retainer with Davis ended as of December 31, 1997 and was not renewed. That retainer had been a comprehensive written document addressing all aspects of the legal services Davis was to provide to Monarch. It required Strother to stay apprised, and to keep Monarch apprised, of all legal developments that could affect Monarch's ability to continue to promote tax-assisted film production services, and remunerated him for this duty. The new retainer was, as the trial judge put it, "decidedly different" (para. 104).

123 The trial judge made the following specific findings on the terms of the new retainer between Davis and Monarch. It did not provide for ongoing remuneration. Strother was to provide advice to Monarch only if Monarch specifically asked for it, and only if Strother agreed to provide it. Strother was free to act for competitors and was not obliged to disclose any information of a competitive nature to Monarch.

124 Throughout 1998 and into 1999, Davis & Company performed "clean-up" and corporate services for Monarch, for which it was paid approximately $98,000. Monarch's executives testified that they relied on Strother during this period to advise if there was a way around the new rules. The trial judge held, however, that under the narrow 1998 retainer, Strother was under no on-going duty to provide Monarch with any advice on these matters. The trial judge saw Strother's fiduciary duty as tied to the limited duties imposed by the retainer. In his view, Strother's fiduciary duty "did not serve to broaden his contractual duty in the sense of requiring him to give advice or [to] provide

information beyond what his firm's retainer required" (para. 45).

125 In late 1997 or early 1998, a new client, Mr. J. Paul Darc, a former employee of Monarch, approached Strother with a new idea that he had come up with on his own for a film production tax-shelter business that he believed might not be barred by the government's new rules. The trial judge found that the limited terms of the Davis-Monarch retainer at this time permitted Strother to take Darc on as a new client and to act for his company, Sentinel Hill Entertainment Corporation ("Sentinel Hill" or "Sentinel") , and that Strother was not obliged to advise Monarch of anything he learned from this new client. While skeptical of Darc's idea (the trial judge found Strother honestly believed the film production tax-shelter business dead for good), Strother agreed to help Darc. In lieu of fees, Strother agreed to take a percentage of any profit. Strother drafted a proposal based on Darc's idea and submitted it in the name of Sentinel Hill to Revenue Canada in March 1998.

126 In October 1998, Revenue Canada responded to the Sentinel Hill proposal with a favourable ruling, followed by a further ruling addressing studio concerns in December 1998. Acting on these rulings, Sentinel Hill closed $260 million in studio production transactions by the end of 1998. Strother's involvement with Sentinel's business led to his leaving Davis & Company as of March 31, 1999. Ultimately, Strother's share of Sentinel's profits appears to have been about $32 million.

127 Strother never told Monarch about Darc's idea. Monarch learned of the favourable tax ruling obtained by Sentinel four months after its issuance. The trial judge found that even if Monarch had been told of the new possibility, it would not have re-entered the film production tax-shelter business in 1998. Monarch was less competitive than others at the time, in part because it had dismantled its operations. The trial judge found that Monarch's claim was essentially based on hindsight.

128 Monarch's case rests on its contention that it continued to look to Strother for advice on film tax shelters in late 1997 and up to September 1998. The trial judge accepted that there were some conversations between Strother and Monarch's principals, Harry Knutson and Stephen Cheikes, in this period. However, consistent with his finding that Monarch had effectively wound up its film production tax-shelter business, he concluded the conversations related to other kinds of business. Because they are critical to the case, I set out the trial judge's findings on the issue:

> What was said at the meetings in 1997 and 1998 was obviously said in the context of the government's termination of tax-shelters and of Monarch having stopped doing that business in the same way as had both Grosvenor Park and Alliance. In other words, Mr. Knutson and Mr. Cheikes were not consulting Mr. Strother for advice on the Rules that had put an end to their tax-shelter business or to explore whether there was any possibility of that business in some way being continued. They had no reason to do so and had no expectation of receiving any advice in that regard. <u>What they wanted to know was whether Monarch could do anything else apart from tax-sheltered financing.</u> Mr. Strother

> says that, in general terms, the focus of the meetings he had with Mr. Knutson in January was to consider what Monarch might do, and Mr. Knutson says that it was not until the end of January that he was able to get Mr. Strother to sit down and focus on talking about new business opportunities. The subject of tax-shelter financing never arose. The only real advice Mr. Strother appears to have given was with respect to the loss-co idea. He was not asked to advise on tax-shelters and he did not do so. [Emphasis added; para. 100.]

129 Monarch sued Strother and Davis & Company for breach of fiduciary duty and breach of confidence. (Other claims and counter-claims need not be considered here.) The trial judge dismissed these claims on the basis of the 1998 Davis-Monarch retainer, and on the basis that nothing confidential to Monarch had been used in services provided to Darc and Sentinel Hill.

130 The Court of Appeal, *per* Newbury J.A., allowed Monarch's appeal in part ((2005), 38 B.C.L.R. (4th) 159, 2005 BCCA 35). It held that the trial judge erred in holding that Strother's duty did not extend beyond what the firm's retainer required. Since Monarch was still a client of the firm, Strother had an ongoing duty to advise Monarch of any developments in the field even under the narrow 1998 retainer. Taking Darc and Sentinel on as clients thus resulted in a conflict of interest: he had a duty to Monarch to tell it about Darc's idea, and a duty to Darc and Sentinel not to do so. In the court's view, the trial judge's conclusion that Monarch would likely not have taken up the opportunity to re-enter the business, had it been advised of the possibility in 1998, did not prevent recovery of equitable remedies against Strother for breach of his fiduciary duty. The court ordered disgorgement to Monarch of all benefit and profit, direct and indirect, received from Sentinel Hill.

III. Analysis

131 In my view, the Court of Appeal erred in holding that Strother's duty to Monarch extended beyond the terms of the 1998 retainer agreement with Monarch, grounding an on-going duty to advise Monarch of any developments in the film production tax-shelter business.

A. *Strother's Duty to Monarch*

132 When does a conflict of interest arise? This is the question at the heart of Strother's appeals. The answer is that a conflict arises when a lawyer puts himself or herself in a position of having irreconcilable duties or interests: *Hilton v. Barker Booth and Eastwood*, [2005] 1 All E.R. 651 (H.L.); *R. v. Neil*, [2002] 3 S.C.R. 631, 2002 SCC 70. It follows that the first question where conflict of interest is alleged is what duty the lawyer owed to the client alleging the conflict. The second question is whether the lawyer owed a duty to another client, or held a personal interest, that conflicted with the first duty.

133 Turning to the first question, how is the fiduciary duty owed to a particular client to be determined? In a case such as this, one looks to the contract between the parties. As La Forest J. put it in *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377, at p. 407:

> ... many contractual agreements are such as to give rise to a fiduciary duty. The paradigm example of this class of contract is the agency agreement, in which the allocation of rights and responsibilities in the contract itself gives rise to fiduciary expectations; see *Johnson v. Birkett* (1910), 21 O.L.R. 319 (H.C.); *McLeod v. Sweezey*, [1944] S.C.R.111; P. Finn, "Contract and the Fiduciary Principle" (1989), 12 *U.N.S.W.L.J.* 76.

A retainer between lawyer and client is essentially an agency agreement, albeit a special one attracting a duty of loyalty. The lawyer commits to doing certain things for the client. It is to this commitment that the fiduciary duty of loyalty attaches.

134 It follows that in a case such as this, one begins by asking what the lawyer and client have agreed the lawyer will do and on what terms. Where the retainer is written, one looks to the words of the retainer. Where it is oral, one asks what the oral terms were. Sometimes, where duties are attached to a task for which the lawyer is retained, but not precisely specified, it may be a question of implying duties. Where, as here, the lawyer and the client do not agree on the terms of the retainer, the trial judge must determine what they are and the case must be judged on that basis unless a palpable and overriding error is established. As Laskin C.J. stated, the nature and scope of a lawyer's retainer is "purely a factual question on which the findings of the trial judge should not ordinarily be upset on appeal save for error arising from misapprehension of the evidence" (*Smith v. McInnis*, [1978] 2 S.C.R. 1357, at pp.1360-61). This is especially true where, as in this case, the alleged breach is an ethical one. The inquiry is inherently fact-based, within the domain of the trial judge.

135 The lawyer owes the client a duty to act loyally for the client in performing as agreed in the retainer. The duty of loyalty is not a duty in the air. It is attached to the obligations the lawyer has undertaken pursuant to the retainer. It is not conflict of loyalties in the abstract that raises problems, but conflicting *duties* - duties that are determined by the retainer. The problem, to use the language of *Hilton*, arises when the lawyer "has conflicting duties to two clients" (para. 44) and cannot prefer one to the other - that in performing his "contractual duties" (para. 35) to one (or taking a personal interest in the matter), he will be in breach of his contractual duties to the other.

136 Insistence on actual conflicting duties or interests based on what the lawyer has contracted to do in the retainer is vital. If the duty of loyalty is described as a general, free-floating duty owed by a lawyer or law firm to every client, the potential for conflicts is vast. Indeed, it is difficult to see how a lawyer or law firm could ever act for two competitors. Consider, as in this case, a specialized tax lawyer who acts for client A and B, where A and B are competitors. Client A may ask for help in minimizing capital gains tax. Client B may seek advice on a tax shelter. The lawyer owes both A and B contractual and associated fiduciary duties. If the duty that the lawyer owes to each client is conceived in broad general terms, it may well preclude the lawyer from acting for each of them; at the very least, it will create uncertainty. If the duty is referenced to the retainer, by contrast, these difficulties do not arise. The lawyer is nonetheless free to act for both, provided the duties the

lawyer owes to client A do not conflict with the duties he owes to client B.

137 This manner of viewing a lawyer's duties conforms to the realities of the legal profession and the needs of clients. Modern commerce, taxation and regulation flow together in complex, sometimes murky streams. To navigate these waters, clients require specialized lawyers. The more specialized the field, the more likely that the lawyer will act for clients who are in competition with each other. Complicating this reality is the fact that particular types of economic activity may be concentrated in particular regions. The obligation of the legal profession is to provide the required services. Yet in doing so, lawyers and law firms must inevitably act for competitors.

138 Practical considerations such as these cannot be used to dilute the rigor of the fiduciary duties that the law rightly demands of lawyers. Rather, they explain why the law has developed a precise conception of the lawyer's duty grounded in the contract of retainer. Our law rightly imposes rigorous fiduciary duties on lawyers, but it also recognizes the need to ensure that fiduciary obligations remain realistic and meaningful in the face of the realities of modern practice.

139 Binnie J., speaking for the Court, captured these realities when he wrote in *Neil*, at para. 29:

> ... a bright line is required. The bright line is provided by the general rule that a lawyer may not represent one client whose interests are *directly* adverse to the immediate interests of another current client... [Emphasis added.]

140 Whether an interest is "directly" adverse to the "immediate" interests of another client is determined with reference to the duties imposed on the lawyer by the relevant contracts of retainer. This precision protects the clients, while allowing lawyers and law firms to serve a variety of clients in the same field. This is in the public interest. As Binnie J. observed in *Neil*, at para. 15:

> An unnecessary expansion of the duty may be as inimical to the proper functioning of the legal system as would its attenuation. The issue is always to determine what rules are sensible and necessary and how best to achieve an appropriate balance among the competing interests.

141 This view of the matter does not conflict with the traditional view of the fiduciary duty owed by lawyer to client. The fiduciary duty between lawyer and client is rooted in the contract between them. It enhances the contract by imposing a duty of loyalty with respect to the obligations undertaken, but it does not change the contract's terms. Rather, it must be molded to those terms. The classic statement of Mason J. in *Hospital Products Ltd. v. United States Surgical Corp.* (1984), 156 C.L.R. 41, at p. 97, has been endorsed by the Privy Council in *Kelly v. Cooper*, [1993] A.C. 205, at p. 215 (*per* Lord Browne-Wilkinson), and in *Hilton*, at para. 30:

> ... the existence of a basic contractual relationship has in many situations provided a foundation for the erection of a fiduciary relationship. In these situations it is the contractual foundation which is all important because it is the

> contract that regulates the basic rights and liabilities of the parties. The fiduciary relationship, if it is to exist at all, must accommodate itself to the terms of the contract so that it is consistent with, and conforms to, them. The fiduciary relationship cannot be superimposed upon the contract in such a way as to alter the operation which the contract was intended to have according to its true construction. [Emphasis added.]

142 For these reasons, I conclude that the starting point in determining whether a conflict of interest arose in a particular case is the contract of retainer between the lawyer and the complaining party. The question then is whether these duties conflicted with the lawyer's duties to a second client, or with his personal interests. If so, the lawyer's duty of loyalty is violated, and breach of fiduciary duty is established. This is the position on the authorities which the courts must follow. This does not, of course, preclude law societies from imposing additional ethical duties on lawyers. They are better attuned than the courts to the modern realities of legal practice and to the needs of clients. If the obligations of lawyers are to be extended beyond their established bounds, it is for these bodies, not the courts, to do so.

143 Here, the trial judge was correct to begin by asking what the contract obliged Strother to do for Monarch. Whatever he undertook to do, he was bound to do it with complete loyalty in accordance with his fiduciary obligation. He could not acquire other duties to other clients or personal interests that might conflict with his duties to Monarch under the retainer. But by the same token, he was entitled to take on duties to other clients or acquire personal interests that were not directly adverse to his duties to Monarch, as defined by the firm's contract of retainer with Monarch.

144 The trial judge, as discussed, found that after the end of 1997, a new and limited retainer was in effect with Monarch. He found that the retainer was "decidedly different" from what it was in 1997 in a number of important respects. Monarch was completely out of the tax-shelter business and the whole basis for the pre-1998 retainer had disappeared. There was no contractual obligation for Strother to provide any advice to Monarch that was not specifically sought and no longer any provision for Davis to be remunerated for advice that was not specifically sought. Strother's only duty on this retainer was to do what Monarch specifically requested and what he, Strother, agreed to take on. There was no duty to provide continuing advice on developments of interest, and no provision for remuneration for being available to provide such advice. There was no contractual requirement for Strother to act exclusively for Monarch, and Strother was free to take on competing clients.

145 The trial judge did not misapprehend the evidence and therefore there is no basis to overturn his findings. Accepting the limited nature of the Davis-Monarch retainer as found by the trial judge, the remaining question is whether Strother's obligation to Darc and Sentinel Hill, or his taking of a personal interest in Sentinel Hill's profits, directly conflicted with his duties to Monarch. The trial judge correctly answered this question in the negative. The retainer permitted Strother to take on new clients or interests. Only if Monarch had specifically asked Strother for advice on new film

tax-shelter opportunities and Strother had agreed to give that advice, could Strother have been under any duty to provide Monarch with such advice, placing him in a conflict of interest with Sentinel Hill. On the trial judge's findings, these things never happened. Unlike Binnie J., I accept the trial judge's findings of fact and conclude that there was no conflict between what Strother agreed to do for Monarch and what he was doing for Darc and himself with Sentinel Hill. Given the changed nature of the lawyer-client relationship, there is no reason to conclude that Strother's capacity to loyally and zealously perform the very limited duties owed to Monarch under the 1998 oral retainer would be affected by his taking a personal interest in Sentinel Hill.

146 The findings of fact that compel this conclusion were open to the trial judge and have not been impugned. The Court of Appeal was bound to proceed on the basis of these findings, unless there was a palpable and overriding error: *Housen v. Nikolaisen*, [2002] 2 S.C.R. 235, 2002 SCC 33. It purported to do so (para. 3). However, and with great respect, it went on to commit critical errors. It held, in effect, that Strother owed Monarch a duty of loyalty that extended beyond the retainer. Instead of asking what duties Strother owed Monarch under the contract of retainer, it simply asked whether Strother was "still acting for" Monarch when he went into business with Sentinel Hill (para. 3). The Court of Appeal did not ask whether the *actual duties* Strother owed to Monarch and to Sentinel Hill respectively, conflicted, as the authorities discussed above required it to do. Rather, it simply asked whether Strother and Davis were in some broad sense "acting for" Monarch and Sentinel Hill at the same time. Nor, as required by the authorities, did the Court of Appeal mold Strother's duty of loyalty to the terms of the contract of retainer; instead, it envisioned an abstract duty of loyalty that would preclude lawyers acting for two competing clients, even though the particular duties owed to each of them do not in fact conflict. Grounding its reasoning in the wrong question and uprooting the duty of loyalty from its contractual context, the Court of Appeal inevitably arrived at the erroneous conclusion that Strother was in breach of his fiduciary duty to Monarch.

147 In this Court, Binnie J. essentially concurs in this reasoning, although he places greater emphasis on Strother's interest in Sentinel Hill, which in his view made Strother a competitor of Monarch, for whom he was "still acting". But the underlying difficulty is the same as in the Court of Appeal, in my respectful opinion; the reasons do not ask whether there was a direct conflict between Strother's duties under his retainer with Monarch and what he was doing, but rather whether there was a decontextualized potential or past conflict.

148 Binnie J. seeks to deal with the trial judge's findings on Strother's limited duties to Monarch by stating that the retainer was not reduced to writing and suggesting that "no exclusions [were] agreed upon", leading him to conclude that "the scope of the retainer may be unclear" - a situation in which one "should not strain to resolve the ambiguities in favour of the lawyer over the client". The trial judge erred in so straining, he concludes (para. 40). But the trial judge expressly found that exclusions were agreed upon, and found no ambiguity. Having made clear, unambiguous findings as to the precise scope of the retainer, he can hardly be accused of failing to resolve non-existent ambiguity in the wrong way. At the end of the day, the trial judge's findings of fact stand firm and

unimpeached, and must be accepted as the foundation of the case.

149 Binnie J. argues that it was wrong for Strother to take an interest in a competitor's business when his firm had worked for Monarch in the past and, indeed, was still continuing to do "clean-up" work for Monarch. The fact that Strother stood to make a great deal of money from the business interest he took in Sentinel Hill might well raise a concern that his personal interest might have led him to be less diligent than he should have been to potential competitors like Monarch. Careful scrutiny is justified when a lawyer takes a personal interest in a business in which a client was previously engaged. Monarch's difficulty is that the trial judge subjected Strother's conduct to this scrutiny, and found no fault in his dealings with Monarch. He found that Strother had honestly and competently advised Monarch that there was no more film production tax-shelter business to be had in the autumn of 1997. He found that Strother believed this to be true, and that other advisers were giving the same advice at the time. He concluded that "the origin of the Sentinel Hill tax-credit/shelter concept, which underlay its request for an advance tax ruling based on the s. 15(*b*) exception, was substantially described by Mr. Darc and Mr. Strother" (para. 91) and that it was Darc's novel idea, an idea not previously contemplated by anyone. It was not until the tax ruling was issued that Strother knew about the exception. (para. 94) Finally, he found that after the expiry of the retainer in 1997, Strother owed no duty to Monarch to advise it of business opportunities, and that the only discussions he had with Monarch related to other types of business, Monarch by then being out of the film production tax-shelter business. The fact that Strother took an interest in Darc's business instead of charging fees, whether one approves of this or not, does not change the trial judge's finding that Strother completely fulfilled his duty to Monarch and was free to engage in the new endeavour with Darc and Sentinel Hill.

150 I conclude that the trial judge's findings stand unimpeached and that on the applicable law, he correctly concluded that Strother did not breach his contractual or fiduciary duty to Monarch.

B. *Remedy*

151 The Court of Appeal ordered Strother to account for all profits made as a result of his participation in Sentinel Hill. It based this on the traditional order for accounts imposed by equity on a trustee who uses the beneficiary's property for his own interest, according to the general rule that when "a fiduciary reaps a benefit as a result of a breach of the duty of loyalty owed to the principal, an action for an accounting of profits will lie": P. D. Maddaugh and J. D. McCamus, *The Law of Restitution* (loose-leaf ed.), at S 27:500.

152 The conclusion that Strother did not breach his contractual or fiduciary duty makes it unnecessary to consider whether the Court of Appeal's remedy was appropriate. However, it may not be amiss to suggest that it is far from clear that an accounting for profits is the appropriate remedy for the breach alleged by Monarch. For the reasons that follow, and without deciding the issue, I simply wish to register the caveat that the matter may not be as free from doubt as the Court of Appeal assumed.

153 The trial judge, after a careful review of the evidence, found that even if Strother had acted as Monarch contends he should have, and even if Strother had never taken an interest in Sentinel Hill, Monarch's position would be the same as it is today. 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 question is whether the remedy of account and disgorgement of profits is appropriate in a case where the breach did not arise from the management of property, where it did not cause the plaintiff any loss, and where viewing the same facts through the lens of contract law, the plaintiff would have recovered nothing.

154 The first question is whether the remedy of account is appropriate where the breach related not to the management of the plaintiff's assets, but to an opportunity that arises to him as trustee or fiduciary.

155 There is some doubt on this matter. It is clear that an accounting for profits is available for breach of fiduciary duty in the classic situation of the management of assets. "However, where the trustee's profit is not made out of the trust property but out of an opportunity that arises to him in his office as trustee, ... many have questioned whether it is equitable or fair that the trust beneficiaries should have a proprietary interest in that profit (rather than a mere personal claim)" (D. Hayton, "Unique Rules for the Unique Institution, the Trust", in S. Degeling and J. Edelman, eds., *Equity in Commercial Law* (2005), 279, at p. 284). Where a fiduciary uses the plaintiff's asset to make a profit for himself, the logic of the remedy of account is clear; presumptively the profits the trustee earned would have been earned for the plaintiff, but for the breach. The plaintiff is simply claiming what is rightfully his. The link between the breach and the remedy of account is arguably less clear where the breach involves using information or an opportunity which the plaintiff would not have enjoyed in any event (as is the case with the profit Strother earned from Darc's idea). Moreover, as Hayton and others have pointed out, the effect may be to give the plaintiff priority over other creditors, should the trustee be insolvent, heightening the unfairness of the remedy of account in these circumstances. See R. Goode, "Proprietary Restitutionary Claims", in W. R. Cornish et al., eds., *Restitution: Past Present and Future* (1998), 63, at p. 69; S. Worthington, *Equity* (2003), at pp. 125-26. It thus may be questioned whether a non-proprietary claim such as Monarch's should attract the remedy of an account for profits.

156 This particular debate is part of a larger discussion throughout the Commonwealth as to the role causation, and other limiting factors used at common law should play in devising appropriate remedies for breach of equitable or fiduciary duties, particularly where, as here, the fiduciary duty arises from the same facts as a concomitant contractual duty. Underlying this debate is the tension between the need to deter fiduciaries from abusing their trust on the one hand, and the goal of achieving a remedy that is fair to all those affected, on the other. Complicating this discussion is the suggestion that if an accounting is ordered without a corresponding loss to the plaintiff, the award takes on the appearance of punitive damages. Where extra deterrence is required, it is better achieved by remedies such as exemplary damages, which unlike account, can be tailored to the particular situation.

157 In England, a distinction is now made between contractual duties of skill and care, and the fiduciary duties that may accompany them: *Bristol and West Building Society v. Mothew*, [1996] 4 All E.R. 698 (C.A.); *Armitage v. Nurse*, [1997] 2 All E.R. 705 (C.A.) (*per* Lord Millett). This position, now seen as "close to orthodoxy", has been described as "the first and essential doctrinal step in opening the way to common law control mechanisms within equitable compensation", inviting " the application of like rules for gauging causation and measure of damages": J. Getzler, "Am I My Beneficiary's Keeper? Fusion and Loss-Based Fiduciary Remedies", in *Equity in Commercial Law*, 239, at p. 251. Lord Millett himself has stated:

> We should not integrate equity and the common law by fusing them; but we should seek to harmonize them wherever possible... . <u>There is no justification for retaining different rules to deal with the same factual situation, which may happen where the case falls within equity's concurrent jurisdiction.</u> [Emphasis added.]
>
> (P. Millett, "Proprietary Restitution", in *Equity in Commercial Law*, 309, at p. 311)

158 In Canada, this Court in recent cases has likewise emphasized the need for harmonizing common law and equitable remedies where the same facts give rise to concurrent duties at equity and law. In *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534, the majority, *per* La Forest J., rejected full equitable compensation in favour of the tort measure of damages for deceit, while the dissent, *per* McLachlin J., insisted on a causal connection between the wrongdoing and the equitable compensation awarded. This fair, flexible approach was affirmed in *Hodgkinson v. Simms*, *per* La Forest J. where compensation for breach of fiduciary duty was awarded on a contractual basis, on the principle that the party wronged is entitled to be put in as good a position as it would have been in had the breach not occurred. These cases were concerned with equitable compensation, not the equitable remedy of account. But at the very least they raise the question whether the remedy of account, like equitable compensation, should be harmonized with common law remedies where the facts support concurrent equitable and legal claims. Since Monarch would have recovered nothing at common law given the trial judge's finding that the alleged breach caused it no loss, the result of harmonization would be to deny Monarch the remedy of account and disgorgement of profits.

C. *Other Issues*

159 My conclusion that breach of fiduciary duty resulting in a loss to Monarch has not been established makes it unnecessary to consider the position of Davis & Company. However, I would like to address a question of interpretation in relation to the *Partnership Act*, R.S.B.C. 1996, c. 348.

160 Section 12 of the *Partnership Act* provides:

> **12** If, by any wrongful act or omission of any partner acting in the ordinary course of the business of the firm or with the authority of his or her partners, loss or injury is caused to any person who is not a partner in the firm or any penalty is incurred, the firm is liable for that loss, injury or penalty to the same extent as the partner so acting or omitting to act.

161 I note first that in the absence of loss or injury, there can be no claim under s. 12 against Davis. The trial judge concluded that Monarch had not suffered any loss or injury (para. 186) and even if it had learned of the advance tax ruling in 1998, Monarch's position would be the same as it is today (paras. 180 ff). His findings stand unimpeached. This renders academic the question of whether Davis is vicariously liable.

162 However, a few words may be apt in relation to the approach taken by Binnie J. In considering Davis' liability under the *Partnership Act*, Binnie J. looks to the principles of vicarious liability established by this Court in *Bazley v. Curry*, [1999] 2 S.C.R. 534, and subsequent cases. In my respectful opinion, it may not be helpful or necessary to look to these principles when considering the partnership's liability under the *Partnership Act*. In *Bazley v. Curry*, and the other cases referred to by Binnie J., the Court was considering when to impose, at common law, vicarious liability on employers for the acts of employees. Here, however, the basis for vicarious liability of the partnership for an act of a partner is contained in the statute.

163 In determining whether Strother was acting in the ordinary course of Davis' business when he committed the allegedly wrongful act or omission, the nature of the activity, and not the manner in which that activity is performed will determine whether that activity falls within the scope of the firm's ordinary business. As the authors note in *Lindley & Banks on Partnership* (8th ed. 2002), at p. 308, "[i]t is perfectly possible for a solicitor to commit a fraud or other wrong in the usual course of his firm's practice"; it is the nature of the underlying transaction that is critical. See also R. Burgess and G. Morse, *Partnership Law and Practice* (1980), at pp. 118-19.

164 On the cross-appeal, I agree with the Court of Appeal and Binnie J.

IV. Conclusion

165 I would allow the appeals and restore the order of the trial judge dismissing all claims against Strother and Davis & Company. I would also dismiss Monarch's cross-appeal and award Strother and Davis & Company their costs in this Court and in the courts below.

Solicitors:

Solicitors for the appellant/respondent Davis & Company, a partnership: Nathanson, Schachter & Thompson, Vancouver.

Solicitors for the respondent/appellant 3464920 Canada Inc. (formerly known as Monarch Entertainment Corporation): Holmes & King, Vancouver.

Solicitors for the appellants/respondents Robert C. Strother, the appellants Strother Family Trust (Trust No. 1) and University Hill Holdings Inc. (formerly known as 589918 British Columbia Ltd.) (Company No. 1), and the respondents Partnership No. 1, Partnership No. 2, Partnership No. 3, Partnership No. 4, Partnership No. 5, Partnership No. 6, Partnership No. 7, Partnership No. 8, Partnership No. 9, Partnership No. 10, Trust No. 1, Trust No. 2, Trust No. 3, Trust No. 4, Trust No. 5, Trust No. 6, Trust No. 7, Trust No. 8, Trust No. 9 and Trust No. 10: Farris, Vaughan, Wills & Murphy, Vancouver.

Solicitors for the respondents J. Paul Darc, Pacific Cascadia Capital Corporation, Sentinel Hill Entertainment Corporation, Sentinel Hill Productions Corporation, Sentinel Hill Productions II Corporation, Sentinel Hill Management Corporation, J. Paul Darc and Leslie Marie Darc, Trustees of the Darc Family Trust, and the said Darc Family Trust, Company No. 1, Company No. 2, Company No. 3, Company No. 4, Company No. 5, Company No. 6, Company No. 7, Company No. 8, Company No. 9 and Company No. 10: Macaulay McColl, Vancouver.

Solicitors for the respondents Sentinel Hill Productions (1999) Corporation, Sentinel Hill 1999-1 Master Limited Partnership, Sentinel Hill 1999-2 Master Limited Partnership, Sentinel Hill 1999-3 Master Limited Partnership, Sentinel Hill 1999-4 Master Limited Partnership, Sentinel Hill 1999-5 Master Limited Partnership, Sentinel Hill 1999-6 Master Limited Partnership, Sentinel Hill 1998 Master Limited Partnership, Sentinel Hill 1998-2 Master Limited Partnership, Sentinel Hill Productions No. 5 Limited Partnership, Sentinel Hill Productions No. 7 Limited Partnership, Sentinel Hill 1999 Master Limited Partnership, Sentinel Hill Ventures Corporation, Sentinel Hill Alliance Atlantis Equicap Millenium Limited Partnership, Sentinel Hill Productions III Corporation, Sentinel Hill Alliance Atlantis Equicap Limited Partnership and Sentinel Hill GP Corporation: Hunter Litigation Chambers Law Corporation, Vancouver.

Solicitors for the intervener the Canadian Bar Association: Lax O'Sullivan Scott, Toronto.

* * * * *

Judgment on motion, released October 18, 2007

THE COURT:

UPON AN APPLICATION by the respondent(appellant on cross-appeal) for a rehearing and directions on the issue of costs in this Court and in the courts below and on the proper ambit of the reference to the trial court regarding profits;

AND HAVING READ the material filed;

IT IS HEREBY ORDERED THAT:

The motion for a rehearing is dismissed without costs. The formal order released on June 1, 2007 is revised to reflect fairly the reasons for judgment. The first and second paragraphs of the formal order are amended to read as follows:

> The appeals from the judgments of the Court of Appeal for British Columbia (Vancouver), Number CA030145, 2005 BCCA 35, dated January 21, 2005, and 2005 BCCA 385, dated July 25, 2005, are allowed in part, McLachlin C.J. and Bastarache, LeBel and Abella JJ. dissenting in part. The cross-appeal is dismissed with costs. In light of the divided success on the main issues, and except as otherwise provided for in this order and in the relevant interlocutory orders of this Court, all parties shall bear their own costs in all courts.
>
> Mr. Strother shall account to Monarch Entertainment Corporation (now 3464920 Canada Inc.) for the personal profit gained directly from the Sentinel group and indirectly through his earnings as a partner of Davis & Company on account of billings to Monarch, but only for the period January 1, 1998 to March 31, 1999. A reference is directed to determine appropriate calculation of Strother's profit. Monarch shall have a money judgment against Strother in the sum thus ascertained. Costs of the reference are to be determined at the discretion of the reference judge.