Focus BUSINESS LAW

Keep it in the family but formalize the relationship

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In a family-owned corporation, the formalities governing standard commercial relationships frequently do not apply, to the peril of the company and individual family members.

For example, where an individual family member provides services to a family operation, there often is no contract in place. In fact, neither party may have any expectation that the individual will be compensated. The individual may be acting out of a sense of obligation and duty to the family enterprise.

Familial relationships may also come in the way of the parties formalizing their expectations in a written contract and having lawyers involved in their business dealings at all.

The informal nature of family-owned corporations, while beneficial to the company's success, can amount to an Achilles' heel. This is particularly so where a family member seeks compensation from the company in the absence of a formal written contract.

The issues set out above came to the fore in a decision of the Ontario Superior Court, *1318847 Ontario Ltd. v. Laval Tool & Mould Ltd.* [2015] ONSC 2664.

In *Laval*, the individual plaintiff, Emmanual Azzopardi ("Emmanuel") commenced an action against the defendant corporation, Laval Tool & Mould Ltd. and its affiliated companies ("Laval Co."), a family-run business specializing in mould manufacturing.

Laval Co. was founded by Emmanuel's father, Loreto Azzopardi ("Loreto"), in 1978. Loreto, who was the president of Laval Co., passed away in 2009.

Emmanuel alleged that between 1999 and 2010, he provided tax-consulting services to Laval Co. In particular, during that period, Emmanuel gathered the information and analysis required for Laval Co. to make claims for federal and provincial tax credits under the scientific research and experimental development ("SRED") program.

Emmanuel was removed from the company's payroll in 1999, following an argument with his father. The argument notwithstanding, Emmanuel alleged that he provided Laval Co. with SRED services in exchange for 25 per cent of the related tax benefits resulting from each fiscal year's claim. However, a written contract between the parties had never been established.

Ultimately, Emmanuel commenced an action against Laval Co., claiming $419,194.30, being 25 per cent of the tax benefits the company received as a result of Emmanuel's services. The action was brought in contract and, alternatively, on the basis of unjust enrichment and *quantum meruit*.

Justice Verbeem of the Ontario Superior Court dismissed Emmanuel's action.

First, the court held that Laval Co. had not entered into any contract with Emmanuel to compensate him for his SRED services. While the court accepted that Loreto authorized Emmanuel to advance Laval Co.'s SRED claims, there was insufficient evidence to show that Loreto agreed to compensate Emmanuel at the rate of 25 per cent of the tax benefits pursuant to any agreement.

With respect to the unjust enrichment claim, the court held that Emmanuel was not entitled to restitutionary compensation under the doctrines of unjust enrichment or *quantum meruit*.

The remedy of *quantum meruit* applies where a "valid contract is found to exist in fact and in law, but there is no clause expressly setting out the consideration for the contract."

In this case, since the court had already found that there was no enforceable contract between Emmanuel and Laval Co., *quantum meruit* did not apply to Emmanuel's claim.

As for unjust enrichment, it was clear that the first two elements of the doctrine had been met. Laval Co. received a tax benefit from the SRED services provided by Emmanuel and Emmanuel suffered a deprivation with respect to the time and effort he spent pursuing the SRED claims.

However, the third branch of the unjust enrichment test had not been met in this case. There was a "juristic reason" for Laval Co.'s enrichment.

The "juristic reason" for Laval Co.'s enrichment was that it was not within the reasonable contemplation of the parties that Emmanuel's SRED services would give rise to a claim for compensation.

Laval Co. never received a formal request from Emmanuel for compensation. Moreover, whenever Emmanuel proposed that he be compensated, Laval Co. refused.

Emmanuel did not challenge this refusal or render an invoice for his services. Nor did he commence a proceeding for compensation.

Emmanuel admitted that he did not pursue the issue of compensation with vigor out of a sense of "familial obligation" and a "debt of gratitude" to his father. In the circumstances, the court held that there was no unjust enrichment. There was no reasonable expectation that Emmanuel would be compensated for his tax-related services to the company.

The *Laval* decision illustrates an important lesson for people who provide services to a family-run business.

The commercial arrangements of a family-run business will not be held to a different standard from any other corporation.

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Tipping: Prosecutors interested in how appellate court views severity of fines

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made from the evidence as a whole is allowed.

As background, the *Finkelstein* affair concerns his access to confidential information regarding major transactions involving public companies and his alleged disclosure.

From 2004 to 2007, he had allegedly disclosed this information to a close friend, an investment advisor at a Canadian bank, who in turn shared this information with fellow investment advisors, friends, families and clients.

The investment advisors proceeded to trade the securities of the public companies in question at a profit before material information they had regarding impending transactions was rendered public. None of the respondents admitted to tipping or insider trading.

The *Finkelstein* case was exclusively tried on the basis of circumstantial evidence put forth by the staff to the regulator, and the OSC adjudicated each transaction separately in regard to the allegations made against each respondent.

The circumstantial evidence put forth before the OSC notably consisted in the respondent lawyer's time dockets, which allowed the OSC to discern when he was working on the targeted transactions.

Also in evidence were the lawyer's recommendations to the boards of directors of the targeted companies and the time they were made. This allowed for an assessment of the respondent lawyer's knowledge of material information.

Evidence also included the time and duration of telephone calls between respondents themselves, texts messages and e-mails, as well as patterns and dates of trades.

On the basis of this circumstantial evidence, the OSC inferred that Finkelstein, his investment advisor friends and the other investment advisors had, on the balance of probabilities, engaged in insider trading or tipping with respect to the stock of three reporting issuers.

> "According to the Alberta Court of Appeal… only 'reasonable' inferences made from the evidence as a whole is allowed.
>
> **Karen Rogers**
> Langlois Lawyers

Fines totalling over $2 million dollars were levied against the accused, in addition to bans from acting as an officer or director of a reporting issuer, ranging from 10 years to permanently depending on the respondent, as well as a 10-year ban on trading securities. Furthermore, the OSC ordered the disgorgement of profits plus costs in the case of the respondents.

For the guilty verdict, the OSC stated that it applied the criteria set forth in *Walton,* of drawing inferences that flow naturally and logically from established facts that are objectively reasonable and logical. Specifically, the OSC did not draw inferences from speculative facts.

The *Finkelstein* case is currently under appeal and is being watched closely by regulators and defence counsel alike. All interested parties look forward to the appellate court's decision as to whether the "inferences" made by the OSC from circumstantial evidence were in fact reasonable and flowed naturally and logically from the established facts.

The views of the appellate court on severity of fines issued against the respondents in *Finkelstein* will also be of interest to regulators, both in Canada and south of the border, which are looking to prosecute individuals suspected of involvement in tipping and insider trading, in light of the importance of fostering confidence in the market and protecting investors.

Also of note is that the regulators' targets appear to be broad enough to include all potential violators, including lawyers.

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