COURT OF APPEAL FOR ONTARIO

CITATION: Hillsburg Stables Inc. v. Gardiner Roberts LLP, 2012 ONCA 95
DATE: 20120213
DOCKET: C53805

Weiler, Armstrong and Rouleau JJ.A.

BETWEEN

Hillsburgh Stables Inc.

Applicant (Appellant)

and

Gardiner Roberts LLP

Respondent (Respondent)

Edward J. Babin, Cynthia L. Spry and Christopher M. Scott, for the appellant Hillsburgh Stables Inc.

Michael Simaan and Mordy Mednick, for the respondent Gardiner Roberts LLP

Heard: January 9, 2012

On appeal from the order of Justice Peter A. Daley of the Superior Court of Justice dated May 3, 2011, with reasons reported at 2011 ONSC 1946.

Rouleau J.A.:

Overview

[1] The issue on this appeal is whether the guarantee and collateral mortgage granted by Hillsburgh Stables Inc. ("Hillsburgh") in favour of the respondent, Gardiner Roberts LLP ("Gardiner Roberts"), is valid and enforceable.

Facts

[2] Hillsburgh is a corporation engaged in the business of harness horse-racing and training. It is owned by a sole shareholder, Frederick Elliott. Elliott, a sophisticated businessman, is also a shareholder holding a significant financial interest in a number of other companies which were involved in the resort industry in the Dominican Republic. These companies, together with Hillsburgh, are referred to collectively as the Elliott Group of Companies (the "EGC"). Elliott is the person with the "final say" with respect to matters related to the EGC.

[3] The EGC, including Hillsburgh, were clients of Gardiner Roberts, a law firm, for several years. Gardiner Roberts provided legal services to the EGC, specifically legal advice on corporate and commercial matters.

[4] By February 2009, the EGC owed Gardiner Roberts over $800,000 in outstanding unpaid accounts. On February 20, 2009, William P. Lambert, the Gardiner Roberts partner responsible for the accounts, advised Elliott that the firm could not provide further legal services to Elliott and the EGC unless payment of the outstanding accounts was made. Instead of a cash payment, Elliott proposed a security arrangement with respect to the accounts.

[5] Further to this proposal, Elliott, on behalf of Hillsburgh, executed a guarantee and provided a collateral mortgage in the amount of $800,000 over Hillsburgh's farm property as security for Gardiner Roberts' accounts. Elliott was

in the Dominican Republic at the time and returned the relevant security documents to Gardiner Roberts on or around February 25, 2009.

[6] As the accounts remained unpaid, Gardiner Roberts issued a notice of sale pursuant to the terms of the collateral mortgage in September 2010. In response, Hillsburgh brought an application seeking an order rescinding the guarantee and extinguishing the collateral mortgage, together with an order that the collateral mortgage be removed from the title of the Hillsburgh farm property.

[7] Hillsburgh claimed that Elliott did not have authority to sign the guarantee and to grant the collateral mortgage.

[8] Alternatively, Hillsburgh sought to have the guarantee and collateral mortgage declared unenforceable on the basis that Gardiner Roberts failed to recommend that Elliott receive independent legal advice prior to executing the security documents.

Application Judge's Reasons

[9] The application judge dismissed Hillsburgh's application, concluding that Elliott had authority to sign the guarantee and grant the collateral mortgage on behalf of Hillsburgh. Further, in the circumstances of this case, the application judge concluded that the security could be enforced despite Gardiner Roberts' failure to recommend that Elliott receive independent legal advice. A summary of his reasons is subsumed under the headings below.

Elliott had authority to sign

[10] Elliott had been recorded as the President, Secretary and Director of Hillsburgh since 2004. Elliott had deposed that he owned the Hillsburgh farm property, and elsewhere testified that he had the "final say" regarding matters related to the EGC. The record demonstrates that Gardiner Roberts looked to Elliott for instructions regarding Hillsburgh around the time that the security documents were executed. As well, Elliott suggested that the Hillsburgh farm property be taken as collateral in an email sent to Mr. Lambert on February 20, 2009.

[11] Moreover, the application judge concluded that regardless of whether Elliott had the actual authority to bind Hillsburgh, the indoor management rule, codified by s. 19 of the *Business Corporations Act*, R.S.O. 1990, c. B.16, provided "a complete answer" to the argument on this issue. In short, s. 19 provides that a corporation cannot assert that a person held out as a director or officer of the corporation cannot exercise the powers usually afforded to such positions – including execution of documents on behalf of the corporation.

Failure to advise Elliott to obtain independent legal advice did not render the guarantee and collateral mortgage unenforceable

[12] The application judge further held that Gardiner Roberts' failure to advise Elliott to seek independent legal advice did not render the guarantee and collateral mortgage unenforceable in the circumstances. An agreement between

a lawyer and a client will remain enforceable where there has been no advantage taken of the client, the client was fully informed, the transaction was fair and the client either had independent legal advice or was not disadvantaged by its absence. The application judge found that Hillsburgh and Elliott were not taken advantage of, that Elliott was a sophisticated businessman and was familiar with guarantees and collateral mortgages. Hillsburgh did not provide evidence that Elliott did not understand the effect of the guarantee and collateral mortgage. Rather, Elliott proposed the security arrangement himself.

There was no duress or unconscionability

[13] The application judge noted that where a law firm enters into a settlement agreement, in which further services are provided in exchange for a guarantee and a mortgage, this arrangement does not amount to economic duress or unjust benefit: *Watson v. 332252 B.C. Ltd.*, 1992 CanLII 197 (BC SC), at p. 24-25; *Sliwinski v. Marks*, 2005 CanLII 6925 (ON SC), rev'd on other grounds (2006), 211 O.A.C. 215 (C.A.). Here, the security taken was, in fact, less valuable than the accounts receivable at the time. There was no evidence to support Elliott's allegation that he was under duress or ill at the time the security documents were executed.

[14] The application judge held that there was no evidence to support the argument that the security arrangement was unconscionable. The value of the

collateral mortgage was less than the accounts owed to Gardiner Roberts in legal fees.

Issues

[15] Hillsburgh raises the following four issues on appeal:

1) Did the application judge commit palpable and overriding errors of fact by finding that: (a) Hillsburgh was part of a group of related companies known as the “clients” in the guarantee, and (b) the guarantee was security in support of a “great indebtedness” owed by Hillsburgh?

2) Did the application judge commit a palpable and overriding error of fact by finding that Hillsburgh derived a personal and substantial benefit from the guarantee?

3) Did the application judge commit an error of law by placing the onus of proving that no advantage was taken and that the security transaction was unfair on Hillsburgh?

4) Did the application judge commit an error of mixed fact and law in finding that: (a) there was no legal requirement for independent legal advice in all the circumstances, and (b) overall, the security transaction was fair despite the lack of independent legal advice?

Analysis

(1) Did the application judge commit palpable and overriding errors of fact by finding that: (a) Hillsburgh was part of a group of related companies known as the “clients” in the guarantee, and (b) the guarantee was security in support of a “great indebtedness” owed by Hillsburgh?

[16] Hillsburgh submits that the application judge’s factual findings are not entitled to deference as he committed significant factual errors in finding that: (a) Hillsburgh was part of a group of companies referred to as the “clients” in the

guarantee, and (b) Hillsburgh was responsible for the $800,000 in outstanding accounts secured by the guarantee.

(a) Hillsburgh is not part of the "clients" referred to in the guarantee

[17] Hillsburgh submits that it is a separate corporate entity involved in the horse racing industry and not one of the "clients" referred to in the guarantee. These "clients" are an independent group of mostly foreign corporations operating in the resort industry (i.e. companies forming part of the EGC). Further, Hillsburgh submits that it is not a shareholder and does not have a proprietary interest in any of the "clients". In its view, because the application judge erroneously stated that Hillsburgh was one of the "clients" for whom the guarantee was provided, it is apparent that the application judge did not understand that Hillsburgh was not one of the companies involved in the resort industry who were responsible for the bulk of the outstanding accounts.

[18] I would not give effect to this submission. The application judge did not state that Hillsburgh was listed as a "client" in the guarantee. In fact, without referring to Hillsburgh, the application judge simply noted at paragraph 61 of his reasons that "the law firm provided additional legal services to the clients referred to in the guarantee".

[19] Further, the application judge referred to Hillsburgh, at paragraph 24 of his reasons, as being "one of a group of companies the parties referred to

collectively as the Elliott Group of Companies". This statement is correct. Hillsburgh is owned by Elliott and was receiving legal services from Gardiner Roberts. The listing of the "clients" in the guarantee is something quite different. There is therefore no error of fact and nothing in the application judge's reasons suggests that he misapprehended the evidence as suggested by Hillsburgh.

(b) References to Hillsburgh's rather than to the "clients'" indebtedness

[20] Hillsburgh submits that the application judge erred in referring to Hillsburgh as being responsible for the $800,000 in outstanding accounts. In its view, it was companies of the EGC, excluding Hillsburgh, that had incurred virtually all of the outstanding accounts.

[21] Gardiner Roberts concedes that the application judge erred in referring to Hillsburgh specifically at various points instead of the EGC but submits that his error in this regard is of no import. I agree. The application judge should have referred to the EGC rather than Hillsburgh. However, when viewed in context, I am satisfied that the application judge was aware that the bulk of the outstanding accounts had been incurred by companies of the EGC involved in the resort industry. Although he refers to Hillsburgh, he clearly intended to refer to the EGC.

(2) Did the application judge commit a palpable and overriding error of fact by finding that Hillsburgh derived a personal and substantial benefit from the guarantee?

[22] Hillsburgh submits that the application judge erred in finding that the security was enforceable as it drew no personal and substantial benefit from providing the guarantee.

[23] Although it is true that Hillsburgh is a distinct corporate entity, the submission that it drew no benefit from the security does not take into account the fact that its owner and directing mind, Elliott, is the person who suggested and decided to put up Hillsburgh's assets as security. Elliott had a strong proprietary interest in all of the companies of the EGC, including Hillsburgh, and benefitted from the ability of these companies to continue receiving legal services from Gardiner Roberts despite the very substantial outstanding accounts.

[24] In that regard, it is significant that, after providing the guarantee and collateral mortgage, Gardiner Roberts provided in excess of $500,000 in additional legal services to the EGC. The value of these additional services is well in excess of the estimated $390,000 value of the security provided by Hillsburgh. Elliott merely pledged one of his assets, the Hillsburgh farm property, in support of his and his companies', including Hillsburgh, ongoing dealings with Gardiner Roberts. For these reasons, I cannot conclude that the application judge erred in finding that Hillsburgh derived a benefit from providing the guarantee.

(3) Did the application judge commit an error of law by placing the onus of proving that no advantage was taken and that the security transaction was unfair on Hillsburgh?

[25] Hillsburgh submits that the application judge erred by placing the onus on it to show that an advantage was taken and that the transaction was unfair to Hillsburgh. Hillsburgh referred the Court to paragraph 46 of the application judge's reasons as support for its submission that the application judge reversed the onus. In that paragraph, the application judge states that "the applicant has provided no evidence that with the benefit of legal advice he would not have executed the security documents on behalf of Hillsburgh, nor has the applicant offered any evidence whatsoever that it has suffered any disadvantage flowing from the lack of independent legal advice."

[26] In my view, this statement does not show that the application judge reversed the onus. First, it comes after the application judge explained why he concluded that Gardiner Roberts did not take advantage of Hillsburgh. Second, the application judge is simply pointing out in paragraph 46 that, in the face of considerable evidence showing no disadvantage or unfairness, Hillsburgh advanced no evidence suggesting that Elliott or Hillsburgh would not have provided the security had they obtained independent legal advice. This does not amount to reversing the onus and, as a result, the application judge employed the correct standard of proof.

(4) Did the application judge commit an error of mixed fact and law in finding that: (a) there was no legal requirement for independent legal advice in all the circumstances, and (b) overall, the security transaction was fair despite the lack of independent legal advice?

[27] Hillsburgh argues first that the application judge erred in finding that there was no legal requirement for independent legal advice in the circumstances. Second, Hillsburgh submits that the application judge erred in concluding that Gardiner Roberts met its onus to show that Hillsburgh was not disadvantaged and that the transaction was not unfair despite the lack of independent legal advice.

(a) No legal requirement for independent legal advice

[28] Hillsburgh submits that in the circumstances of this case, there was a legal requirement that Hillsburgh receive independent legal advice in relation to the security transaction pursuant to rule 2.06(2.1) of the Law Society of Upper Canada, *Rules of Professional Conduct*, which provides as follows:

> When a client intends to pay for legal services by transferring to his, her or its lawyer a share, participation or other interest in property or in an enterprise, other than a non-material interest in a publicly traded enterprise, the lawyer shall recommend but need not require that the client receive independent legal advice before accepting a retainer.

[29] The application judge referred to rule 2.06(2.1) and confirmed that it applied not only to the acceptance of a retainer but also to the circumstances of this case. I agree.

[30] It is conceded by Gardiner Roberts that it did not comply with rule 2.06(2.1). According to the record, Gardiner Roberts failed to recommend that Elliott and Hillsburgh receive independent legal advice. As a result, Gardiner Roberts breached rule 2.06(2.1).

[31] The rule however only requires that a lawyer *recommend* that a client seek independent legal advice before providing the lawyer with an interest in property. It does not require that a client actually receive such advice. As noted by the application judge, there is no requirement for actual receipt of independent legal advice pursuant to the rule but rather a requirement that such advice be recommended.

[32] Despite this breach, for the reasons that follow, I have concluded that the security remains nonetheless enforceable as there was no disadvantage resulting from the lack of independent legal advice and the transaction was fair.

(b) Security transaction was fair despite the lack of independent legal advice

[33] Hillsburgh submits that once it is established that a lawyer obtained security from his or her client for the payment of accounts, without recommending that the client seek independent legal advice, the lawyer bears the onus of showing that there was no disadvantage to the client.

[34] In light of the fiduciary relationship that exists between the lawyer and his or her client, Hillsburgh also maintains that it will be very difficult for the lawyer to

show that there was no disadvantage to the client. As explained by Megarry J. in *Spector v. Ageda*, [1973] Ch. 30, at p. 47:

> [T]he solicitor must be remarkable indeed if he can feel assured of holding the scales evenly between himself and his client. Even if in fact he can and does, to demonstrate to conviction that he has done so will usually be beyond possibility in a case where anything to his client's detriment has occurred. Not only must his duty be discharged, but it must manifestly and undoubtedly be seen to have been discharged.

[35] In Hillsburgh's submission, the application judge either misunderstood the high onus resting on Gardiner Roberts or misapplied it on the facts of this case. I would not give effect to this ground of appeal.

[36] As previously discussed, although Gardiner Roberts breached rule 2.06(2.1) by not recommending that Elliott and Hillsburgh receive independent legal advice, it does not automatically follow that the security becomes unenforceable.

[37] The application judge identified and considered the correct legal principles applicable to the determination of disadvantage or unfairness in relation to the enforceability of a security transaction. Specifically, the lawyer must show that "no advantage was taken of the client; that the transaction was fair; that the client was fully informed; and that the client had competent legal advice or was not disadvantaged by its absence": Paul M. Perell, *Conflicts of Interest in the Legal Profession* (Markham, Ont.: Butterworths Canada, 1995), at p. 105.

[38] Applying these legal principles to the record, the application judge found that: (1) Gardiner Roberts did not take advantage of Hillsburgh and Elliott; (2) the security transaction was not unconscionable and there was no duress; (3) Elliott was fully informed in that he was most familiar with security transactions and proposed same; and (4) Elliott and Hillsburgh did not suffer a disadvantage as a result of not having received independent legal advice.

[39] These findings are entitled to deference by this court. In the circumstances of this case, there is a sufficient factual basis for these findings. Some of the relevant facts are as follows:

1. As of the date of the execution of the security documents, the outstanding accounts of the EGC were in excess of $800,000 and Gardiner Roberts was also completing work for Hillsburgh at that time.
2. Gardiner Roberts indicated to Elliott that it could no longer continue to provide legal services to him and the EGC unless a cash payment was made.
3. Several companies of the EGC were in serious financial difficulties and there was a need for continued legal representation.
4. It was Elliott who proposed providing the guarantee and collateral mortgage on behalf of Hillsburgh for the outstanding accounts.
5. Elliott was the owner of Hillsburgh and was authorized to sign on its behalf.
6. Elliott is a sophisticated businessman who is, as noted by the application judge, “most familiar with guarantees and collateral mortgages.”

7. Elliott took approximately five days before executing and returning the security documents.

[40] In summary, these facts support the application judge's conclusion that, despite the failure to recommend the receipt of independent legal advice, Gardiner Roberts did not take advantage of Hillsburgh and Elliott and the security transaction was not unfair. The guarantee and collateral mortgage are therefore enforceable.

Conclusion

[41] As a result, I would dismiss the appeal and award the respondent costs of the appeal fixed in the amount of $6,000, inclusive of disbursements and applicable taxes.

"Paul Rouleau J.A."
"I agree K.M. Weiler J.A."
"I agree R.P. Armstrong J.A."

Released: February 13, 2012