COURT OF APPEAL FOR ONTARIO

CITATION: Steinberg v. Ellis Entertainment Corp., 2012 ONCA 362
DATE: 20120531
DOCKET: C54767

MacPherson, Gillese and MacFarland JJ.A.

BETWEEN

Michael Steinberg

Plaintiff (Respondent)

and

Ellis Entertainment Corp. and Stephen Ellis

Defendants (Appellant)

AND BETWEEN

Stephen Ellis

Plaintiff by Counterclaim (Appellant)

and

Michael Steinberg

Defendant by Counterclaim (Respondent)

Paul D. Guy and Faren H. Bogach, for the appellant Stephen Ellis

Kevin D. Sherkin and Robert A. Gold, for the respondent

Heard: May 10, 2012

On appeal from the order of Justice Glenn A. Hainey of the Superior Court of Justice dated November 24, 2011.

Gillese J.A.:

[1] This appeal raises a significant pleadings issue. A corporation and an individual jointly defended an action. The corporation also counterclaimed. It became insolvent and its assets were acquired by its first-ranking secured creditor. The creditor assigned the counterclaim to the individual. The individual obtained an order to continue the counterclaim. The corporation's defence was then struck out. Is the individual permitted to amend his pleadings to make them consistent with the counterclaim? In the circumstances of this case, it is my view that he cannot.

THE FACTS IN BRIEF

[2] Michael Steinberg ("Steinberg") was the former Chief Operating Officer and General Counsel of Ellis Entertainment Corp. (the "Corporation"). He began a wrongful dismissal lawsuit against the Corporation and Stephen Ellis ("Ellis") personally. At the time, Ellis controlled the Corporation. He was its President and Chief Executive Officer, as well as a director and officer.

[3] In the action, Steinberg sought damages of $250,000 for wrongful dismissal, back wages, vacation pay, and oppression. He sought relief against Ellis personally for vacation pay and back wages, pursuant to the provisions of the *Employment Standards Act, 2000*, S.O. 2000, c. 41.

[4] The Corporation and Ellis defended the claim in a joint pleading, consisting of a statement of defence (the "joint statement of defence") and a counterclaim (the "Counterclaim"). In the joint statement of defence, the Corporation and Ellis alleged that Steinberg voluntarily resigned from his employment with the Corporation or, alternatively, that Steinberg had engaged in serious misconduct that justified termination of his employment for cause. Paragraph 20 of the joint statement of defence set out Steinberg's alleged misconduct, the essence of which is that he secretly attempted to compete against the Corporation while employed by it. In the joint statement of defence, the Corporation and Ellis also alleged that Steinberg had received all vacation pay and compensation to which he was entitled.

[5] The Counterclaim was brought only by the Corporation. In it, the Corporation sought damages of approximately $1 million for the wrongdoing alleged in the joint statement of defence. The Counterclaim itself contained no additional allegations against Steinberg. Ellis personally did not claim anything by means of counterclaim.

[6] The Corporation became insolvent.

[7] On January 13, 2011, all of the Corporation's assets, including the Counterclaim, were acquired by the first-ranking secured creditor, Knightscove Media Corp. ("Knightscove").

[8] On March 18, 2011, Knightscove assigned the Counterclaim to Ellis.

[9] On March 31, 2011, based on the Corporation's failure to attend discovery, Steinberg successfully moved to strike out the Corporation's statement of defence. The Counterclaim was not struck out. Ellis, through his counsel, participated in the motion.

[10] In accordance with rule 19.02 of the *Rules of Civil Procedure*, R.R.O. 1990, Reg. 194 (the "Rules"), as a consequence of the Corporation's defence being struck out and it being noted in default, the Corporation was deemed to admit the truth of the allegations of fact contained in the statement of claim.

[11] On May 20, 2011, Ellis obtained an order that allowed him to continue the Counterclaim in his name (the "order to continue").

[12] Steinberg did not challenge the assignment of the Counterclaim to Ellis nor did he appeal the order to continue.

[13] Ellis moved for leave to amend his statement of defence and counterclaim to make it consistent with the order to continue. The amendments would permit him to make the same allegations of fact as those that had been advanced in the joint statement of defence and which had been struck out as against the Corporation.

[14] Steinberg resisted the motion.

The First Order

[15] By order dated September 15, 2011, Master Sproat granted the motion and allowed the amendments to be made (the “first order”).

[16] In brief reasons, the Master explained as follows. The Corporation’s defence was struck as a result of its failure to attend discovery. The merits of its defence and proof of the underlying facts were not adjudicated. Ellis has a continued right to defend. Ellis’s continued denial of the claim is unaffected by the striking of the Corporation’s defence or deemed admissions of the facts upon the noting in default.

[17] As there was no order striking the Counterclaim, it was properly before the court. Ellis has obtained an order to continue and no issue has been taken with that order. The Rules are clear that amendments shall be granted unless there is prejudice that cannot be compensated for by costs and Steinberg had not advanced prejudice. Therefore, Ellis should be permitted to make the amendments.

[18] Steinberg appealed.

The Order Under Appeal

[19] By order dated November 24, 2011 (the “order under appeal”), Hainey J. allowed Steinberg’s appeal and dismissed Ellis’s motion to amend. He reasoned as follows.

[20] Because the Corporation's statement of defence was struck out, it is deemed to have admitted the allegations in the statement of claim, including that Steinberg's employment was wrongfully terminated. The Counterclaim contained no allegations specific to it but, rather, adopted paragraph 20 of the joint statement of defence which recites a number of allegations of misconduct by Steinberg during his employment with the Corporation. The serious allegations are inconsistent with, and contrary to, the Corporation's deemed admissions.

[21] Against this background, it would be an abuse of process to allow Ellis to continue to assert the serious allegations in the Counterclaim.

[22] The court should review a proposed pleading to determine whether it is legally tenable and should refuse an amendment as legally untenable if it is clearly impossible of success.

[23] Given the deemed admissions by the Corporation, the allegations in the Counterclaim are not legally tenable and are impossible of success. Hence, it was an error for the Master to have permitted Ellis to amend his pleadings.

THE ISSUES

[24] On appeal to this court, Ellis asks that the order under appeal be set aside and the first order be restored. He submits that Hainey J. erred by:

1. failing to take into account that he (Ellis) acquired the Counterclaim before the deemed admissions were made by the Corporation; and

2. allowing a collateral attack to be made against the order to continue.

ACQUISITION OF THE COUNTERCLAIM BEFORE THE DEEMED ADMISSIONS

[25] For the purposes of this submission, Ellis asks that three dates be kept in mind:

- January 13, 2011: Knightscove acquired the Counterclaim
- March 18, 2011: Knightsbridge assigned the Counterclaim to Ellis
- March 31, 2011: The Corporation's statement of defence is struck out.

[26] On this issue, Ellis argues as follows. The Corporation lost all of its rights and interests in the Counterclaim on January 13, 2011, when Knightscove acquired the Corporation's assets. Ellis acquired the right to pursue the Counterclaim on March 18, 2011, when it was assigned to him. By the time the Corporation's statement of defence was ordered struck out on March 31, 2011, and the deemed admissions were made by the Corporation, the Corporation no longer had the right to advance the Counterclaim: he had that right. Accordingly, Ellis contends, the deemed admissions of the Corporation had no impact on the legal viability of the Counterclaim and Hainey J. erred in failing to recognize the significance of the timing of the relevant events.

[27] I do not accept this submission. In my view, although Hainey J. did not expressly advert to the timing of events, there is no error in his reasoning.

[28] The effect of the assignment was to give Ellis the right to pursue the Counterclaim on behalf of the Corporation. He stood in the Corporation's shoes for the purpose of pursuing the Counterclaim. He could not have a better claim than the Corporation. Therefore, as I will explain, when the Corporation's statement of defence was struck out, there was an effect on Ellis's ability to continue the Counterclaim.

[29] The Counterclaim seeks relief for allegations set out in the joint statement of defence and is supported by no other allegations. As a consequence of the Corporation's defence being struck out and it being noted in default, the Corporation was deemed to admit the truth of the allegations of fact contained in the statement of claim: see rule 19.02 of the Rules. Accordingly, the Corporation was deemed to admit that it had wrongfully terminated Steinberg's employment. It could no longer assert that Steinberg had wrongfully attempted to compete against it during his employment with the Corporation because those allegations are inconsistent with, and contrary to, the Corporation's deemed admission that it had wrongfully terminated Steinberg's employment.

[30] Thus, given the deemed admissions by the Corporation, it was not possible for the Corporation to factually establish the allegations of wrongdoing

that underpinned its claims in the Counterclaim. As it couldn't factually establish the allegations, it would be impossible for the Corporation to legally make out the claims in the Counterclaim. In short, the claims in the Counterclaim are clearly impossible of success on the part of the Corporation. As Hainey J. observed, the court should refuse an amendment if it is not tenable at law: see *Old Willoughby Realty Ltd. v. Mathews Southwest Developments Ltd.*, 2009 CanLII 55352 (Ont. S.C.), at para. 19; and *Essa v. Panontin,* 2010 ONSC 691.

[31] As I have already noted, Ellis stands in the shoes of the Corporation and cannot have a better claim than it does. Because the Corporation could not factually or legally establish the claims in the Counterclaim, it would be an abuse of process to allow Ellis to amend his pleadings so that he could assert the claims in the Counterclaim.

THE COLLATERAL ATTACK ARGUMENT

[32] A collateral attack is an attack made against a court order or judgment in proceedings other than ones whose specific object is the reversal, variation or nullification of the order or judgment: see *R. v. Wilson*, [1983] 2 S.C.R. 594, at p. 599.

[33] Ellis submits that the order under appeal is a collateral attack on the order to continue. This submission runs as follows.

[34] Through the assignment, Ellis acquired the Counterclaim. The order to continue gave Ellis the right to continue the Counterclaim against Steinberg in his own name. The order under appeal effectively invalidates the order to continue because it prevents Ellis from continuing the Counterclaim. Had Steinberg wished to prevent the Counterclaim from being continued, Steinberg had to appeal the order to continue. He did not. The order to continue was not in issue before Hainey J. Therefore, it was not open to Hainey J. to make the order under appeal because it amounted to a collateral attack on the order to continue.

[35] Again, I reject this submission.

[36] As I have already explained, the effect of the striking out of the Corporation's statement of defence and the deemed admissions means it would be impossible for the Corporation to succeed in establishing the claims in the Counterclaim. In those circumstances, the amendments that Ellis sought to make were not tenable at law. It was for that reason that Hainey J. concluded that it would be an abuse of process to permit the amendments to be made. Accordingly, the order under appeal does not amount to a collateral attack on the order to continue.

DISPOSITION

[37] Accordingly, I would dismiss the appeal with costs to the respondent fixed, on consent, at $2,500, inclusive of disbursements and all applicable taxes.

Released: May 31, 2012 (“J.M.”)

“E.E. Gillese J.A.”
“I agree. J.C. MacPherson J.A.”
“I agree. J. MacFarland J.A.”