COURT OF APPEAL FOR ONTARIO

CITATION: Martenfeld v. Collins Barrow Toronto LLP, 2014 ONCA 625
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Doherty, Cronk and Hourigan JJ.A.

BETWEEN

Marvin Martenfeld and Jekel Enterprises Inc.

Plaintiffs (Respondents)

and

Collins Barrow Toronto LLP and
Collins Barrow Toronto Inc.

Defendants (Appellants)

Lou Brzezinski and Catherine MacInnis, for the appellants

Michael Tamblyn and Ryan Hauk, for the respondents

Heard: April 22, 2014

On appeal from the judgment of Justice Joan L. Lax of the Superior Court of Justice, dated July 24, 2013, with reasons reported at 2013 ONSC 4792.

Cronk J.A.:

[1] This appeal concerns the financial consequences of an equity partner's withdrawal from an accounting partnership to join a competitor firm. The principal issue is the proper interpretation of a provision in the partnership agreement that requires a withdrawing and competing equity partner to pay liquidated damages to the partnership, in an amount equal to two times the partner's "Permanent Capital".

I. Background

(1) The Parties

[2] The respondent, Marvin Martenfeld ("Martenfeld"), is a chartered accountant and a former partner of the appellant, Collins Barrow Toronto LLP ("CBT LLP" or the "partnership"), an accounting firm. He has practised his profession for almost 40 years. Over the decades, he carried on his accounting practice in various large accounting firms. In about 1992, he merged his practice with those of several other accountants to form Daren, Martenfeld, Carr and Company.

[3] In approximately 1996, Daren, Martenfeld, Carr and Company dissolved. The former partners worked under a decentralized arrangement until 2003, when Martenfeld and others merged their practices under the name DMCT LLP. From 2003 to 2005, Martenfeld served as DMCT LLP's managing partner and a member of the Executive Committee.

[4] In the mid-1990s, Martenfeld and other partners created a management company to provide administrative and consulting services to their partnership, and to permit the partners to engage in income-splitting with related persons, typically their spouses or other family members.

[5] In 2008, the DMCT LLP partners joined the Collins Barrow franchise of accounting firms, adopting the name of CBT LLP and renaming the management company Collins Barrow Toronto Inc. ("CBT Inc.").

[6] The shareholders of CBT Inc. are holding companies owned or controlled, directly or indirectly, by each of CBT LLP's partners. In Martenfeld's case, the respondent, Jekel Enterprises Inc. ("Jekel"), a company owned by Martenfeld's wife, was a shareholder of CBT Inc. [1]

(2) 2004 Partnership Agreement

[7] Sometime in 2003, the DMCT LLP partners decided to enter into a written partnership agreement. The partners executed the agreement in about June 2004, with an effective date of January 1, 2004 (the "Partnership Agreement").

[8] In conjunction with the Partnership Agreement, the predecessor management company to CBT Inc. – DMCT Consultants Inc. – executed promissory notes in favour of each of its shareholders that were attached as Schedule "D" to the Partnership Agreement. Jekel's promissory note, dated January 1, 2004, was in the amount of $269,841 (the "Jekel Loan"). By the terms of Jekel's promissory note, payment of the principal owing on the Jekel Loan, without interest, was due "on such date as may be determined by [the

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[1] I will refer in these reasons to CBT LLP and CBT Inc., collectively, as the "CBT Group", and to Martenfeld and Jekel, collectively, as the "Martenfeld Group".

partnership]" or "on such earlier date as may be provided in the [Partnership Agreement]".

[9] The Partnership Agreement contains several provisions governing the financial rights and obligations of the parties on the withdrawal of an equity partner.

[10] Section 11.2.2 of the Partnership Agreement is the key provision at issue on this appeal. This section creates a financial disincentive for equity partners to leave the partnership and enter into competition, by imposing an obligation on the withdrawing partner to pay liquidated damages to CBT LLP. The amount of the damages payable is equal to two times the withdrawing partner's "Permanent Capital", subject to set-off against identified sums owed by the CBT Group to the withdrawing partner. Section 11.2.2 reads in part:

> *Any Equity Partner who withdraws from the Partnership and competes with the Partnership* within the meaning of Section 11.2.1, *agrees to pay the Partnership, as a genuine pre-estimate of liquidated damages, and not a penalty, an amount equal to two times his or her then Permanent Capital (as paid-up or required to be paid-up)* and agrees that any balance in his or her Capital Account, if any, as well as any capital loans made as contemplated in Section 4.7, will constitute a down-payment that may be retained by (or paid by the Corporation to) the Partnership by way of set-off to be applied against any amounts owing in respect of this obligation. …Any balance of the Capital Account owing to the Partner shall be paid out as contemplated in Section 11.5 and any balance of any capital loans made

> as contemplated in Section 4.7 shall be paid out as contemplated therein. [Emphasis added.]

[11] The term “Permanent Capital” is defined under s. 1.1 of the Partnership Agreement in this fashion:

> “Permanent Capital” in respect of an Equity Partner in a Fiscal Year, means the lowest level of capital required of such Equity Partner at any time during such Fiscal Year, and which amount may not be reduced at any time during such Fiscal Year, as determined at the beginning of each Fiscal Year for each Equity Partner by Special Resolution.

[12] Section 1.1 of the Partnership Agreement also contains the following relevant definitions:

> “Capital Account” shall mean each Partner’s capital account as maintained pursuant to Section 9.2.
>
> ….
>
> “Equity Partner” means a Partner who has an interest in the profits and losses of the Partnership as well as an interest in the capital (i.e. equity) of the Partnership and whose name is set out in Schedule “A” attached hereto, together with those persons who become Equity Partners pursuant to the provisions of this Agreement from time to time, excluding an ex-Partner.
>
> ….
>
> “Related Person” means a Person related to an Equity Partner within the meaning of the Income Tax Act and designated by the Equity Partner in writing.
>
> ….
>
> “Withdrawal” shall mean the withdrawal of a Partner pursuant to Section 11.1, other than by reason of

> Expulsion, death, retirement or disability, and "Withdrawing" or "Withdrawn" shall have a similar meaning.

[13] Article 9 of the Partnership Agreement deals with CBT LLP's capital. Sections 9.1 and 9.2 state in part:

> The paid-up capital of the Partnership shall consist of the Permanent Capital contributions made by the Equity Partners as determined by Special Resolution from time to time, including upon admission to the Partnership. An Equity Partner will be notified of his or her required paid-up capital contribution and this required paid-up capital must be injected into the Partnership within 30 days of the date of notification of the paid-up capital requirement from the Partnership or as agreed by the Partnership (by Special Resolution, excluding the applicable Partner) [s. 9.1].
>
> An individual Capital Account shall be established and maintained for each Equity Partner. Each Equity Partner's Capital Account in a Fiscal Year shall consist of his or her Permanent Capital for such Fiscal Year and (a) shall be increased by the Equity Partner's allocable share of income allocated pursuant to this Partnership Agreement, and (b) shall be decreased by (i) all amounts distributed to that Equity Partner and (ii) that Equity Partner's allocable share of losses allocated pursuant to this Partnership Agreement [s. 9.2].

[14] The Partnership Agreement also imposes financial obligations on the CBT Group on the withdrawal of an equity partner from CBT LLP. Section 4.7 states:

> Upon an Equity Partner ceasing to be an Equity Partner, the Corporation may, subject to applicable law, distribute to the related Shareholder such dividends as may be determined by the Board of Directors of the Corporation. After the distribution of such dividends, if any, the Corporation shall, subject to applicable law,

> redeem the related Shareholder's Shares for the stated redemption price thereof specified in the Corporation's articles.
>
> Any capital loans due to the Equity Partner or a Related Person by the Corporation shall be repayable over twenty-four months following the redemption of the Shares on the same basis as the Equity Partner's Permanent Capital of the Partnership as contemplated in Section 11.5, mutatis mutandis, for greater certainty subject to the set-off or similar rights set out in Sections 11.2.2 and 11.5.

[15] Thus, by reason of s. 4.7, on the withdrawal of an equity partner CBT Inc. is authorized or obliged: 1) to distribute dividends to shareholders related to the withdrawing partner; 2) after the distribution of such dividends, if any, to redeem shares in CBT Inc. held by shareholders related to the withdrawing partner; and 3) following such share redemption, to repay any capital loans due to the withdrawing partner or a related shareholder.

[16] Under s. 11.5 of the Partnership Agreement, the CBT Group is obliged to pay a withdrawing equity partner: 1) his or her "Permanent Capital", if any, standing to the credit of the withdrawing partner in his or her Capital Account as at the end of the partnership fiscal year immediately preceding the partner's departure date (s. 11.5(a)); 2) the amount, if any, of any declared dividends on his or her shares in CBT Inc. and the required amount for redemption of those shares (s. 11.5(b)); and 3) his or her share of net income for the year of withdrawal, pro-rated to the date of the partner's departure (s. 11.5(c)).

(3) Events Preceding the Partnership Agreement

[17] Both before and after the creation of CBT LLP, the partners prepared three sets of annual financial statements: 1) financial statements concerning the business and financial affairs of their accounting practice (the “LLP Statements”); 2) financial statements regarding the business and financial affairs of the firm’s management company (the “Inc. Statements”); and 3) financial statements combining the LLP and the Inc. Statements (the “Group Statements”).

[18] In April 2004, two months prior to the formal execution of the Partnership Agreement, Martenfeld, then the managing partner of DMCT LLP, circulated a memorandum to the partners (the “April 2004 Memorandum”), attaching the LLP, Inc. and Group Statements as of December 31, 2003 and a “Capital Equalization Schedule” for the 2003 year-end. The CBT Group maintains that the Capital Equalization Schedule reflected the year-end capital of each partner, based on the Group Statements, and the amount of each equity partner’s Permanent Capital, as well as other capital requirements for the forthcoming year.

[19] At annual meetings, the CBT LLP partners approved the annual LLP Statements and Capital Equalization Schedule. The approved schedule as of December 31, 2003 included a column entitled “2004 Permanent Capital”. In 2005, this heading was replaced with the phrase “Anchor Capital Required”, a term not mentioned in the Partnership Agreement.

[20] The CBT Group maintains that, after 2003, each partner's Permanent Capital in any year was the amount of his or her "Anchor Capital" disclosed in the annual Capital Equalization Schedule.

[21] As of December 31, 2003, the Group Statements recorded a balance of $321,301 in Martenfeld's Capital Account, while the Capital Equalization Schedule showed his "2004 Permanent Capital" as $230,000. In contrast, the LLP Statements for the same period indicated that Martenfeld's Capital Account had a negative balance of ($334).

(4) Conversion of Partnership Capital to Shareholder Loans

[22] In November 2004, some months after the execution of the Partnership Agreement, the CBT LLP partners decided to convert some of the partnership capital into capital loans (the "Capital Conversion"). The Capital Conversion had two objectives: first, to limit the partners' potential personal liability to creditors of the partnership; and, second, to equalize the amounts in each partner's Capital Account so as to eliminate discrepancies among the amounts that individual partners had at risk in the partnership. To effect the Capital Conversion, the partners moved amounts from their Capital Accounts in CBT LLP to shareholder loan accounts in CBT Inc., and each partner's Capital Account was "flattened" to $10,000.

[23] The Capital Conversion was reflected in the 2004 LLP Statements, which showed the year-end balance in the Capital Account of each partner as $10,000. From 2004 onwards, the partners' Capital Accounts were again reconciled to the agreed $10,000 at the end of each fiscal year, and this amount was consistently recorded in the annual LLP Statements. The Inc. Statements, in turn, recorded the specific amounts of each of the shareholder loans as "Loans Payable to Shareholders" or "Loans Payable to Related Parties".

(5) Proposed 2007 Amendments to the Partnership Agreement

[24] In the fall of 2007, the Executive Committee of CBT LLP proposed several amendments to the Partnership Agreement. These included the deletion of the s. 1.1 "Permanent Capital" definition and the introduction of the term "Capital Loan", defined to mean shareholder loans from related corporations. In addition, a significant revision of s. 11.2.2 was proposed. If approved, the s. 11.2.2 revision would have required a withdrawing equity partner to pay liquidated damages equal to two times his or her "Capital Account and Capital Loan", rather than two times his or her "Permanent Capital".

[25] The CBT LLP partners never approved the proposed 2007 amendments.[2]

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[2] Prior to trial, the CBT Group claimed that Martenfeld was bound by a new partnership agreement, effective July 1, 2009. The alleged 2009 agreement contained substantively different partnership withdrawal terms from those in the 2004 Partnership Agreement. The CBT Group abandoned this claim on the eve of trial. As a result, the trial proceeded on the accepted basis that the 2004 Partnership Agreement governed the respective rights and obligations of the parties.

(6) Martenfeld's Withdrawal from CBT LLP

[26] Martenfeld was a full equity partner in CBT LLP. On June 30, 2009, he delivered written notice of his withdrawal from the partnership. CBT LLP accepted his withdrawal on July 2, 2009 and the parties agreed to a departure date of August 31, 2009. The following day, September 1, 2009, Martenfeld joined a competing accounting firm.

[27] Under the terms of the Partnership Agreement, Martenfeld was entitled to leave CBT LLP and join a competing firm. However, his decision to do so triggered serious personal financial consequences for him. Upon withdrawal from CBT LLP, Martenfeld lost his vested retirement benefits, valued at approximately $600,000 at the time of his departure. He also became obliged to pay CBT LLP liquidated damages under s. 11.2.2 of the Partnership Agreement.

[28] Unfortunately, Martenfeld's departure from CBT LLP rapidly became acrimonious and disputes arose regarding his rights and obligations on withdrawal, as well as his conduct as a partner. The parties disagreed about the amount of his Permanent Capital for the purpose of his liquidated damages obligation under s. 11.2.2, and whether CBT Inc. was obliged to repay the Jekel Loan. In addition, CBT LLP alleged that Martenfeld had breached his contractual and professional obligations to the partnership in numerous ways, entitling CBT LLP to substantial damages.

[29] The Martenfeld Group eventually sued. It took the position that Martenfeld's Permanent Capital was $10,000, as reflected in his Capital Account with CBT LLP and recorded in the LLP Statements. On this basis, Martenfeld's indebtedness for liquidated damages under s. 11.2.2 totalled $20,000 (two times his Permanent Capital).

[30] The Martenfeld Group also claimed that the Jekel Loan to CBT Inc. formed no part of the calculation of Martenfeld's Permanent Capital and that it was to be paid on Martenfeld's departure, together with Martenfeld's share of CBT LLP's 2009 income, his Permanent Capital of $10,000, and Jekel's share of dividends and management fees from CBT Inc., under ss. 4.7 and 11.5 of the Partnership Agreement.

[31] Finally, the Martenfeld Group sought damages against the CBT Group, including punitive, aggravated and exemplary damages, for alleged misconduct by CBT LLP's Executive Committee in relation to Martenfeld's departure from the partnership and in the conduct of the litigation.

[32] The CBT Group resisted these claims on several bases. First, it maintained that Martenfeld's Permanent Capital was his "Anchor Capital" listed in the partnership's 2009 annual Capital Equalization Schedule. Since Martenfeld's recorded Anchor Capital was $160,494 as of December 31, 2008, this would yield $320,988 in liquidated damages owing by Martenfeld under s. 11.2.2.

[33] Second, according to the CBT Group, the shareholder loans to CBT Inc., including the Jekel Loan, were not intended to be genuine loans but, instead, formed part of CBT LLP's partnership capital. The CBT Group argued that after set-off of the Jekel Loan (in the amount of $176,201 as of December 31, 2009) and the $10,000 shown on the LLP Statements as Martenfeld's Permanent Capital, Martenfeld owed $134,787 as liquidated damages ($320,988 - $186,201).

[34] Further, and in any event, the CBT Group claimed that the Martenfeld Group was not entitled to payment of the Jekel Loan or other amounts under ss. 4.7 and 11.5 because Martenfeld had breached his contractual and professional duties, including his fiduciary duties, to his partners prior to his departure from the partnership. The CBT Group counterclaimed against the Martenfeld Group for significant damages and/or disgorgement of profits on account of Martenfeld's alleged misconduct.

II. Trial Judge's Decision

[35] The trial judge rejected the CBT Group's urged construction of the Partnership Agreement, described above. She made the following critical findings:

> (1) only the LLP Statements reflected the partners' s. 9.2 Capital Accounts in the partnership. After 2004, the LLP Statements consistently listed the

amount in each partner's Capital Account as $10,000;

(2) the Group Statements reflected the financial picture of the accounting practice as a whole. However, the Group Statements had no bearing on the obligation of a withdrawing equity partner to pay liquidated damages;

(3) Martenfeld's Permanent Capital at the time of his departure from CBT LLP was $10,000 – the amount in his Capital Account as set out in the December 31, 2009 LLP Statements, and did not include the Jekel Loan;

(4) pursuant to ss. 11.5(a) and (c), CBT LLP owed Martenfeld $10,000 on account of his Permanent Capital and $33,500 on account of his share of partnership profits pro-rated to the date of his departure;

(5) Martenfeld, in turn, owed CBT LLP $20,000 on account of liquidated damages under s. 11.2.2;

(6) the CBT Group was required to repay the Jekel Loan in accordance with s. 4.7. Pending any agreement to the contrary by the parties, the trial judge fixed the amount of the Jekel Loan at $198,450, as set out in the June 2009 Inc. Statements; and

(7) under ss. 4.7 and 11.5, Jekel was entitled to its share of declared dividends, and its pro-rata share of management fees for the month of August 2009 from CBT Inc.

[36] The effect of these findings was that the CBT Group owed the Martenfeld Group the net aggregate amount of $260,788.25, after deduction of the $20,000 in liquidated damages owed by Martenfeld to CBT LLP.

[37] The trial judge also dismissed the parties' competing assertions of misconduct as against each other and their associated damages claims, including the CBT Group's counterclaim.

III. Issues

[38] The CBT Group advances three main issues on appeal:

1) Did the trial judge err by holding that Martenfeld's Permanent Capital for the purpose of s. 11.2.2 of the Partnership Agreement was $10,000 as of the date of his departure from CBT LLP?

2) Did the trial judge err by holding that the CBT Group is obliged to repay the Jekel Loan, in the amount of $198,450?

3) Did the trial judge err by holding that Jekel is entitled to its share of declared dividends, together with its share of management fees for the month of August 2009, and that Martenfeld is entitled to his pro-rata share of CBT LLP's 2009 profits?

IV. Analysis

(1) Approach to Contractual Interpretation and Standard of Review

[39] In determining the legal rights and obligations of the parties under a written contract, the primary task of a reviewing court is to ascertain the objective intentions of the parties and the scope of their understanding regarding the rights and obligations at issue. Recently, in *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, the Supreme Court, at para. 47, reiterated the well-established principle that courts are to undertake this task with a view to "the contract as a

whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract."

[40] This interpretive approach governs the construction of the Partnership Agreement. Under this approach, while the circumstances surrounding the formation of the disputed contract are relevant as an interpretive aid, they cannot overtake the written words used by the parties. As the *Sattva* court explained, at para. 57, "[t]he interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract".

[41] The *Sattva* court also held, at para. 50, that: "Contractual interpretation involves issues of mixed fact and law as it is an exercise in which the principles of contractual interpretation are applied to the words of the written contract, considered in light of the factual matrix." Thus, questions of contractual interpretation generally attract a deferential standard of review: *Sattva* at para. 52. Further, although it may be possible "to identify an extricable question of law from within what was initially characterized as a question of mixed fact and law", "courts should be cautious in identifying extricable questions of law in disputes over contractual interpretation" since, among other considerations, "the goal of contractual interpretation, to ascertain the objective intentions of the parties, is inherently fact specific": *Sattva* at paras. 53-55.

[42] On this appeal, the CBT Group challenges the trial judge's findings regarding the meaning of "Permanent Capital" and her quantification of the amount of liquidated damages owed by Martenfeld under s. 11.2.2. The CBT Group also attacks her findings concerning the relevance of the Capital Equalization Schedules, the Group Statements, and the parties' discussions leading up to the formation of the Partnership Agreement. These findings are either findings of fact or, on the authority of *Sattva*, findings of mixed fact and law. In either case, they attract significant deference from this court. Absent palpable and overriding error, appellate intervention with these findings is precluded.

(2) Martenfeld's Permanent Capital

(i) Contractual Definition of "Permanent Capital"

[43] The trial judge held that Martenfeld's "Permanent Capital" was the same as the amount stated in his Capital Account, as reflected in the LLP Statements. She also held that shareholder loans to CBT Inc., specifically, the Jekel Loan, are irrelevant to the quantification of a partner's "Permanent Capital" under s. 11.2.2.

[44] The CBT Group challenges these core holdings on four main grounds. First, it argues that the trial judge's interpretation of the phrase "Permanent Capital" under s. 11.2.2 – that a partner's "Permanent Capital" is the same as the

amount in his or her Capital Account – renders the s. 1.1 definition of “Permanent Capital” meaningless.

[45] As I will explain, I do not accept that the trial judge’s interpretation of the phrase “Permanent Capital” renders the s. 1.1 definition of that term ineffective or devoid of meaning.

[46] Under s. 1.1, “Permanent Capital” is defined as the “lowest level of capital” required of an equity partner in a partnership fiscal year, which amount may not be reduced at any time during the relevant year. The use of the term “lowest level” allows for the possibility that the amount of capital required from an equity partner may fluctuate during the course of a fiscal year. However, only the lowest required amount of capital in any fiscal year constitutes the partner’s Permanent Capital in that year.

[47] Section 1.1 also contemplates that the partnership will pass a special resolution fixing each partner’s Permanent Capital at the beginning of each fiscal year. During the fiscal year, a partner’s Permanent Capital may only change if the partnership agrees to increase his or her required capital investment.

[48] Section 1.1 defines the term “Capital Account” as each partner’s capital account as maintained pursuant to s. 9.2. Section 9.2 says that an equity partner’s Capital Account is to consist of his or her Permanent Capital for a given fiscal year, and increase on account of the partner’s allocated share of

partnership income and decrease on account of his or her draws and allocated share of partnership losses. Accordingly, under s. 9.2., the amount of a partner's Capital Account is subject to fluctuation during the course of a fiscal year, to account for his or her share of partnership income and losses, and distributions received.

[49] The combined effect of these provisions, in my view, is that a partner's Capital Account consists of his or her Permanent Capital plus an adjustment for his or her flow of income, draws and losses. In other words, a partner's Capital Account is made up of his or her Permanent Capital, subject to change only by agreement of the partners, and an amount calculated with reference to the partner's allocated share of partnership income and losses and the partner's draws during the fiscal year. In this fashion, the amount of a partner's Capital Account may increase and decrease throughout a fiscal year, while the amount of his or her Permanent Capital remains constant.

[50] The CBT LLP partners gave effect to these provisions by agreeing to equalize the partners' Capital Accounts. In the first LLP Statements after the Capital Conversion, regardless of any fluctuations in a partner's Capital Account during the fiscal year, the partnership set each partner's Capital Account at $10,000. Thereafter, both at the beginning of a new fiscal year and at the end of the preceding fiscal year, the amount of a partner's Capital Account was the same fixed amount of $10,000. Each new fiscal year, the partnership approved

this amount, thereby fixing the amount of each partner's Permanent Capital for that year.

[51] The partners confirmed this equalization on an annual basis in successive partnership fiscal years. On the trial judge's undisputed findings, both CBT LLP and CBT Inc. filed income tax returns based on this fixed amount for each partner's Capital Account.

[52] It follows, in my opinion, that while the trial judge erred when she held, without qualification, that a partner's Capital Account and Permanent Capital are "one and the same", this error was not overriding. The result is the same. The trial judge held that the amount in Martenfeld's Capital Account at the time of his withdrawal was $10,000, and so his liquidated damages under s. 11.2.2 were $20,000. As I read the relevant provisions of the Partnership Agreement, the partnership's approval of all partners' $10,000 Capital Account balances for each new fiscal year set all partners' Permanent Capital at $10,000, regardless of intra-year fluctuations in the amount in their individual Capital Accounts. Thus, Martenfeld's Permanent Capital was $10,000, both in 2008 and 2009, and his liquidated damages obligation was $20,000 – two times the amount of his Permanent Capital – at the time of his withdrawal from CBT LLP.

[53] I see nothing in this interpretation of the s. 1.1 definitions of "Permanent Capital" and "Capital Account" and s. 9.2 of the Partnership Agreement, as

implemented under the Capital Conversion, that renders the definition of the term "Permanent Capital" ineffective. To the contrary, it recognizes the partners' agreement that an equity partner's Capital Account was to consist of his or her Permanent Capital on a year-to-year basis. It was open to the partners to also agree, as they did in November 2004, that the amounts of the partners' Capital Accounts were to be fixed on an annual basis, to achieve the risk reduction and income-enhancing benefits afforded by the Capital Conversion. This arrangement neither contradicted nor denuded the definition of "Permanent Capital" under s. 1.1 of the Partnership Agreement.

[54] I also fail to see any palpable and overriding error in the trial judge's ruling that the term "Permanent Capital" in s. 11.2.2 of the Partnership Agreement does not extend to shareholder loans, specifically, the Jekel Loan, shareholder capital, the management company or "Related Persons". The provisions of the Partnership Agreement overwhelmingly support this conclusion.

[55] Neither the s. 1.1 definitions of "Permanent Capital" and "Capital Account" nor s. 9.2 refer to shareholder or capital loans, the partnership's management company or "Related Persons". The phrase "Permanent Capital" is defined under s. 1.1 solely with reference to equity partner capital contributions – not amounts loaned to the management company by way of shareholder or capital loan, from either an equity partner or a person related to an equity partner.

[56] Similarly, under both ss. 9.1 and 9.2, the focus of the partners' approach to the firm's capitalization is on Permanent Capital contributions made by the equity partners from time to time. Sections 9.1 and 9.2 contain no mention of shareholder or capital loans, or financial contributions made to the partnership's management company by partners or persons related to them. Instead, s. 9.1 states that the paid-up capital of the partnership "shall consist of the Permanent Capital contributions made by the Equity Partners" and that an equity partner would be notified of his or her "required paid-up capital contribution". Section 9.1 also provides for the timing of payment of a partner's "paid-up capital requirement". Thus, s. 9.1 equates Permanent Capital contributions with required paid-up capital contributions *by an equity partner*, to the partnership.

[57] In addition, s. 4.7 of the Partnership Agreement, quoted above, differentiates between capital loans due to a departing equity partner or a "Related Person" by the management company, on the one hand, and the departing partner's Permanent Capital, on the other hand. Section 4.7 stipulates that such loans are repayable by CBT Inc. over 24 months "on the same basis as the Equity Partner's Permanent Capital of the Partnership". If a partner's Permanent Capital included shareholder or capital loans to CBT Inc., this language would be redundant.

[58] Moreover, s. 11.2.2, also quoted above, expressly distinguishes between: 1) a partner's Permanent Capital and capital loans, and 2) the balance in a departing partner's Capital Account and capital loans.

[59] In light of all these provisions, I see no error in the trial judge's holding that a partner's "Permanent Capital" under s. 11.2.2 of the Partnership Agreement is contained in the partner's Capital Account recorded in the LLP Statements and does not include shareholder or capital loans to CBT Inc.

[60] Consequently, I would reject the CBT Group's contention that a partner's Permanent Capital is the same as his or her "Anchor Capital" as set out in the Capital Equalization Schedules. Recall that the Capital Equalization Schedules derive from the Group Statements, which reflect the combined financial position of both CBT LLP and CBT Inc. The financial affairs of CBT Inc. include shareholder loans. Nothing in the Partnership Agreement provides that a partner's Permanent Capital is to be quantified by reference to the financial position of the entirety of the CBT Group enterprise. As I have said, Article 9 and ss. 1.1 and 11.2.2 do not mention the combined financial position of the partnership and the management company, the terms "Anchor Capital" or "Related Persons", or shareholder or capital loans.

[61] I therefore agree with the trial judge's ruling that neither the Group Statements, nor the Capital Equalization Schedules that are based on them, are

the appropriate reference to quantify liquidated damages under s. 11.2.2 of the Partnership Agreement.

(ii) Commercial Absurdity Claim

[62] The CBT Group also argues that the trial judge's interpretation of s. 11.2.2 of the Partnership Agreement results in commercial absurdity.

[63] In support of this argument, the CBT Group points out that under s. 11.2.2, a departing equity partner is afforded three years from the date of his or her departure within which to pay liquidated damages to CBT LLP. Based on this and similar payment terms set out under the Partnership Agreement, the CBT Group submits that it is illogical and commercially nonsensical to calculate liquidated damages at two times $10,000, based on the fixed amount of a departing partner's Permanent Capital reflected in the LLP Statements. In other words, three years would not be required to pay such a nominal amount.

[64] The CBT Group also emphasizes the material discrepancies that existed in the amounts of the partners' Capital Accounts at the time the Partnership Agreement was entered into. On the trial judge's interpretation of s. 11.2.2, given these discrepancies, if two equity partners withdrew from CBT LLP after the date of the Partnership Agreement but before the Capital Conversion, the amount of their respective liquidated damages obligations would have varied significantly,

based on the different amounts in their Capital Accounts. This result, the CBT Group submits, would be inequitable and nonsensical.

[65] Again, I disagree. In my opinion, neither the three-year payment term under s. 11.2.2 nor the fact that equity partners who left CBT LLP prior to the Capital Conversion might be obliged to pay disparate amounts of liquidated damages leads to commercial absurdity.

[66] But for the Capital Conversion, s. 11.2.2 could have tied the amount a departing partner owed for liquidated damages to the partner's stake in the partnership. The loss to the partnership of a higher contributing partner, who had a larger stake in CBT LLP, would be more detrimental to the partnership than the loss of a lower contributing partner, who had a smaller stake in CBT LLP.

[67] In such a case, a discrepancy between the amounts of liquidated damages payable by two departing partners would not lead to inequitable or nonsensical results. The greater liquidated damages due from the partner with a larger stake in the partnership would simply reflect the greater adverse impact on the partnership of his or her departure and, hence, the need for a greater withdrawal disincentive. In these circumstances, a three-year payment term may well have been required for, and benefitted, the departing partner who had a significant balance in his or her Capital Account.

[68] However, on implementation of the Capital Conversion, the potential for such discrepancies was eliminated. By equalizing the amounts in each partner's Capital Account, the partners also quantified and equalized the amounts of each partner's Permanent Capital. After the date of the Capital Conversion, therefore, the amount of liquidated damages payable to CBT LLP by departing equity partners was similarly equalized, and capped at two times $10,000.

[69] It is important to emphasize that the CBT LLP partners were free to introduce appropriate amendments to the Partnership Agreement at the time of the Capital Conversion or at any time thereafter to avoid the consequences of a post-Capital Conversion application of s. 11.2.2. This could have been achieved in a variety of ways, including, for example, by amending the Partnership Agreement to state that "Permanent Capital" under s. 11.2.2 was to be quantified in accordance with the Capital Equalization Schedules or Group Statements. Suitable amendments were not made. Indeed, when proposed in 2007, they were not pursued or implemented. The consequences that flow from this omission must be borne by CBT LLP.

(iii) Consideration of Surrounding Circumstances

[70] The CBT Group next argues that the trial judge erred in her interpretation of s. 11.2.2 by failing to consider the context surrounding the formation of the Partnership Agreement. The CBT Group complains, in particular, that the trial

judge failed to take account of the amount of Permanent Capital listed in the April 2004 Memorandum and of the discussions of the CBT LLP partners about liquidated damages at the time of formation of the Partnership Agreement.

[71] I accept that the trial judge’s reasons do not expressly mention the April 2004 Memorandum. I also accept that both the April 2004 Memorandum and the various financial documents attached to it formed part of the circumstances surrounding the formation of the Partnership Agreement.

[72] That said, I conclude that the trial judge’s failure to specifically allude to the April 2004 Memorandum and to the partners’ pre-contract discussions about liquidated damages is of no consequence.

[73] First, contrary to the CBT Group’s assertion in its factum, the April 2004 Memorandum does not set out the partners’ Permanent Capital. Rather, the Group Statements attached to the April 2004 Memorandum include a “Statement of Partners’ Capital Accounts” and the attached Capital Equalization Schedule lists each partner’s “2004 Permanent Capital”. The trial judge noted the 2004 Permanent Capital list, as well as the post-2004 introduction in the schedules of the term “Anchor Capital”.

[74] Second, the trial judge was mindful of the principles governing contractual interpretation. Although the Supreme Court’s decision in *Sattva* was released after this trial, the principle that the circumstances or factual matrix surrounding

the making of a contract are relevant to its interpretation was well-established under the applicable authorities: see for example, *Dumbrell v. The Regional Group of Companies Inc.*, 2007 ONCA 59, 85 O.R. (3d) 616, at paras. 53-54; *Ventas, Inc. v. Sunrise Senior Living Real Estate Investment Trust*, 2007 ONCA 205, 85 O.R. (3d) 254, at para.45.

[75] The trial judge referred specifically to *Dumbrell* and *Ventas*, as well as *Eli Lilly & Co. v. Novopharm Ltd*., [1998] 2 S.C.R. 129 and stated, at para. 37:

> [T]he goal of interpretation of contracts is to determine the intention of the parties with reference to the words used in drafting the document, possibly read in light of the surrounding circumstances prevalent at the time. Evidence of one party's subjective intention is irrelevant. Extrinsic evidence need not be considered at all when the document is clear and unambiguous on its face. It should be presumed that the parties intended the legal consequences of their words. This makes it possible to interpret a plainly-worded document in accordance with the true contractual intent of the parties and not by the intent they ascribe to it with hindsight once differences have arisen.

[76] This description of the controlling interpretive principles, and the trial judge's application of those principles, reflect no error. The trial judge's statement that the surrounding circumstances of a contract are "possibly" relevant to determining the intention of the contracting parties derives from the language of the Supreme Court in *Eli Lilly*, at para. 54. *Sattva* confirms prior provincial appellate court decisions that evidence of the surrounding

circumstances of a contract is relevant in the contractual interpretive exercise, within limits. The *Sattva* court put it this way, at para. 57:

> The goal of examining [evidence of surrounding circumstances] is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract. … While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement. [Citations omitted.]

See also *Sattva* at para. 58.

[77] Third, the trial judge's reasons reveal that she did take account of those circumstances relevant to the interpretation of the Partnership Agreement, in particular, the general import and significance of the Group Statements and the Capital Equalization Schedules and the use of the term "Anchor Capital" in the Capital Equalization Schedules after the date of the Partnership Agreement.

[78] Having considered these matters, it was unnecessary for the trial judge to specifically mention the April 2004 Memorandum or the values ascribed to the partners' Capital Accounts and Permanent Capital in the 2003 year-end documents attached to the April 2004 Memorandum. The reasons confirm that the trial judge understood and came to grips with the CBT Group's argument that Martenfeld's "Anchor Capital" as set out in the 2008-2009 Capital Equalization Schedule was the proper basis for quantifying his "Permanent Capital" under s.

11.2.2. The trial judge rejected this interpretive argument, for clear and cogent reasons. I see no error in her having done so.

[79] For similar reasons, I also cannot accept that the trial judge erred by failing to treat the CBT LLP partners' discussions about liquidated damages as a relevant consideration when interpreting s. 11.2.2 of the Partnership Agreement. Extrinsic evidence regarding the intention of contracting parties need not be considered when the words employed in the contract in question are unambiguous. More precisely, evidence of the contracting parties' subjective intentions is irrelevant to the interpretation of the final language employed by the parties in a contract: *Eli Lilly* at paras. 54 to 58; *SeaWorld Parks & Entertainment LLC v. Marineland of Canada Inc*., 2011 ONCA 616, 282 O.A.C. 339, para. 16. I do not read the *Sattva* decision as altering this principle.

[80] In this case, the trial judge concluded, in effect, that the term "Permanent Capital" in s. 11.2.2 was unambiguous and that, on a proper reading of the Partnership Agreement as a whole, its meaning was clear. For the reasons set out above, I agree. It follows that the trial judge did not err by declining to resort to the evidence of the partners' pre-contract discussions regarding liquidated damages to interpret s. 11.2.2.

(iv) Trial Judge's Consideration of the LLP Statements and the 2007 Proposed Amendments

[81] The CBT Group advances one further argument in aid of its contention that the trial judge's interpretation of "Permanent Capital" under s. 11.2.2 is fatally flawed. It submits that by taking account of the 2009 LLP Statements and the 2007 proposed amendments to the Partnership Agreement, the trial judge "relied on the wrong extrinsic evidence to quantify Permanent Capital". I disagree.

[82] With respect to the 2009 LLP Statements, the CBT Group's argument, at heart, is that the trial judge should have relied on the 2009 Group Statements, rather than the 2009 LLP Statements, when interpreting s. 11.2.2. I would reject this argument.

[83] The trial judge found, correctly, that only the LLP Statements set out the balance in Martenfeld's Capital Account in the CBT LLP partnership, as distinct from the entire CBT Group enterprise, at the time of his withdrawal from the partnership. The trial judge relied on the 2009 LLP Statements only to quantify the amount of Martenfeld's Permanent Capital, rather than to interpret the meaning of "Permanent Capital" under the Partnership Agreement. She was right to do so.

[84] I would also reject the CBT Group's complaint concerning the trial judge's treatment of the 2007 proposed amendments to the Partnership Agreement.

[85] As I read her reasons, the trial judge did not rely on the fact or nature of these proposed amendments to interpret s. 11.2.2 of the Partnership Agreement, or to quantify Martenfeld's Permanent Capital. She simply observed that the effect of the CBT Group's urged interpretation of s. 11.2.2 was to accord that section a meaning that corresponded with the unapproved 2007 proposed amendments, rather than with the language of s. 11.2.2 as it exists under the Partnership Agreement. This was an accurate observation.

[86] The conclusion that the trial judge did not rely on the 2007 proposed amendments to interpret s. 11.2.2 is bolstered by the placement in her reasons of her challenged comments regarding the amendments. Before alluding to the amendments, the trial judge had already held that the meaning of "Permanent Capital" was clear on the face of the Partnership Agreement and that the Group Statements and the "Anchor Capital" values relied on by the CBT Group did not provide the basis for quantifying Martenfeld's Permanent Capital.

(3) Repayment of the Jekel Loan

[87] In its factum, the CBT Group argued that it was not obliged to repay the Jekel Loan and that the amount of that loan could be set-off against the amount of liquidated damages owing by Martenfeld to CBT LLP. However, during oral argument, the CBT Group acknowledged that if Martenfeld's Permanent Capital at the time of his departure is properly to be quantified in the manner adopted by

the trial judge, the Jekel Loan is repayable, presumably after deduction of the $20,000 in liquidated damages owed by Martenfeld.

[88] Since I have concluded that the trial judge did not commit a palpable and overriding error in her quantification of the liquidated damages payable by Martenfeld under s. 11.2.2 of the Partnership Agreement, it is unnecessary to address this ground of appeal. As conceded by the CBT Group and as found by the trial judge, the Jekel Loan is repayable by the CBT Group.

(4) Other Amounts Awarded by the Trial Judge

[89] It remains to consider the CBT Group's challenge to certain of the trial judge's other awards to the Martenfeld Group. The CBT Group argues that the trial judge erred by holding: 1) that Jekel is entitled to its share of declared dividends, and management fees for the month of August 2009 from CBT Inc.; and 2) that Martenfeld is entitled to his pro-rata share of the CBT LLP 2009 partnership profits. These claims may be dealt with summarily.

[90] First, with respect to Jekel's share of dividends declared by CBT Inc., there is no dispute that, in 2009, CBT Inc. declared and distributed a dividend to its shareholders in the total amount of $375,642, without allocating any amount of that dividend to Jekel. Under ss. 4.7 and 11.5(b) of the Partnership Agreement, quoted above, CBT LLP was obliged on Martenfeld's departure from the partnership to pay any declared dividends on Jekel's shares in CBT Inc. prior to

the redemption of Jekel's shares. In mid-April 2010, CBT Inc. redeemed Jekel's shares, effective August 31, 2009.

[91] In these circumstances the trial judge held, at para. 56:

> While dividends are within the discretion of the Board of Directors [of CBT Inc.], the Board had an obligation to exercise this discretion fairly and with an even hand as the shares provided to the related corporations carried identical rights. The partnership was obliged to pay dividends declared up to the date of Martenfeld's departure prior to [the redemption of] Jekel's shares.

[92] I agree. While the declaration of dividends by CBT Inc. was discretionary, the CBT Group has been unable to point to any provision in the Partnership Agreement that authorizes CBT Inc. to differentiate among similarly situated shareholders to award dividends to some shareholders but not others. Absent such a provision, the terms of ss. 4.7 and 11.5(b) apply and CBT LLP is indebted to Martenfeld for Jekel's share of the 2009 declared dividend. The trial judge fixed this amount at $35,557. I did not understand the CBT Group to challenge the quantum of Jekel's share of the 2009 dividend.

[93] Next, the CBT Group attacks Martenfeld's $33,500 award on account of his pro-rata share of CBT LLP's 2009 partnership profits, up to the date of his withdrawal from the partnership (eight months). In support of its challenge to this award, the CBT Group renews some of its complaints, advanced at trial, concerning Martenfeld's conduct prior to and at the time of his departure from CBT LLP, which the CBT Group says breached the Partnership Agreement.

[94] The trial judge reviewed the CBT Group's complaints concerning Martenfeld's conduct in detail. She provided lengthy reasons for her findings that virtually all these complaints lacked any evidentiary support or merit. With respect to those aspects of Martenfeld's conduct that she viewed as problematic or deserving of censure, the trial judge held that the CBT Group failed to establish any factual or legal basis for its damages claims or that Martenfeld's conduct had occasioned any harm.

[95] The CBT Group has not demonstrated that these findings are tainted by any palpable and overriding error. It simply disagrees with the trial judge's findings. This affords no basis for appellate interference with the trial judge's award of a share of the 2009 partnership profits to Martenfeld.

[96] I come, finally, to the question of the management fees awarded to Jekel for the month of August 2009.

[97] The trial judge's reasons provide no explanation for this award, which the trial judge fixed in the amount of $3,281.25. The CBT Group argues that there was no evidence at trial that CBT Inc. paid management fees to its shareholders, separate and apart from dividends. The Martenfeld Group has pointed to no evidence to the contrary. In these circumstances, there being no apparent evidentiary or contractual support for this award, I would set aside the award of management fees made by the trial judge.

V. Disposition

[98] For the reasons given, save only for the trial judge's $3,281.25 award of management fees in favour of Jekel, which I would set aside, I would dismiss the appeal.

[99] Since it has succeeded on virtually all issues on appeal, I would award the Martenfeld Group its costs of the appeal on the partial indemnity scale, as agreed by the parties. The Martenfeld Group may submit its brief written submissions regarding the quantum of those costs to the Registrar of this court, within 14 days from the date of these reasons. The CBT Group may deliver its brief responding submissions on costs, within 14 days thereafter.

Released:

"SEP 10 2014"
"DD"

"E.A. Cronk J.A."
"I agree Doherty J.A."
"I agree C.W. Hourigan J.A."