COURT OF APPEAL FOR ONTARIO

CITATION: Lee v. Lalu Canada Inc., 2020 ONCA 344
DATE: 20200603
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Pepall, van Rensburg and Paciocco JJ.A.

BETWEEN

Gerard Lee

Applicant (Appellant)

and

Lalu Canada Inc.

Respondent (Respondent)

Benjamin Salsberg, for the appellant

Michael M. Title and Patricia Virc, for the respondent

Heard: April 29, 2020 by videoconference

On appeal from the judgment of Justice Laurence A. Pattillo of the Superior Court of Justice, dated September 10, 2019, with reasons reported at 2019 ONSC 4664.

van Rensburg J.A.:

I. INTRODUCTION

[1] The appellant, Gerard Lee, is the former Chief Executive Officer ("CEO") of the respondent, Lalu Canada Inc. ("Lalu"), a real estate investment company. Lee asserts that the application judge erred in dismissing his application for advance funding of his legal costs to defend an action brought against him in his capacity as a former officer of Lalu. The application judge concluded that a strong *prima*

facie case of fraud had been made out against Lee in connection with "acquisition fees" he had received in respect of development properties acquired by Lalu, as a result of which he was disentitled to advance funding.

[2] The following arguments are made on appeal: (1) the application judge erred in his interpretation of Lee's consulting agreement with Lalu, which Lee relies on as the basis for his entitlement to the acquisition fees; (2) the application judge erred in his assessment of the evidence about whether Lalu knew Lee was receiving the fees and whether, by receiving the fees indirectly, Lee was concealing the fees from Lalu; and (3) the application judge erred in applying too low a legal threshold for overcoming the presumption that Lee was acting in good faith and concluding that he was not entitled to advance funding.

[3] For the reasons that follow, I would dismiss the appeal.

II. LEGAL FRAMEWORK

[4] Lee's application for advance funding was based on the provisions of Lalu's Unanimous Shareholders' Agreement (dated December 15, 2015 and amended and restated in June 2017) and s. 124 of the *Canada Business Corporations Act*, R.S.C. 1985, c. C-44 (the "CBCA").

[5] The relevant provision of the Unanimous Shareholders' Agreement reads as follows:

> To the fullest extent permitted by law, the Corporation will indemnify and save harmless each director and officer and former director or officer of the Corporation … against all costs, charges and expenses … reasonably incurred by the director or officer in respect of any civil, criminal, administrative, investigative proceeding to which the director or officer is made a party by reason of being or having been a director or officer of the Corporation[.]

[6] Section 124 of the CBCA provides for the indemnification of individuals, including former directors and officers of a corporation, for their reasonable costs incurred in defending an action in which they are involved because of their association with the corporation. Advance funding of costs is available, without court approval under s. 124(2) or with court approval under s. 124(4), subject to the individual fulfilling the conditions of s. 124(3), one of which is that the individual "acted honestly and in good faith with a view to the best interests of the corporation". Subsection 124(7) provides that an individual, entity or corporation can apply to the court for an order approving indemnity.

[7] The test on an application under s. 124 for advance funding is set out in this court's decision in *Cytrynbaum v. Look Communications Inc.*, 2013 ONCA 455, 116 O.R. (3d) 241, leave to appeal refused, [2013] S.C.C.A. No. 379, [2013] S.C.C.A. No. 377. Advance funding should be denied only where the court is persuaded, on a preliminary assessment of the merits, that the corporation has made out a strong *prima facie* case of bad faith on the part of the applicant for funding. In *Cytrynbaum*, Sharpe J.A. noted that the strong *prima facie* case test "is

a stringent test that gives significant weight to the protection of officers and directors. It ensures that they will ordinarily receive advance funding but leaves open the possibility that advancement will be denied when there is strong evidence of bad faith": at para. 56.

III. THE APPLICATIONS IN THE COURT BELOW

[8] The application for advance funding in this case was in respect of Lee's defence to an action commenced by HZC Capital Inc. ("HZC") (a CBCA company that serves as an investment vehicle for monies from China) and other plaintiffs, including Lalu (75% owned by HZC and incorporated to invest in the Canadian real estate development industry) and other related entities. The action claims breach of contract, breach of fiduciary duty and statutory duties, conspiracy, and fraud. The plaintiffs allege that they were the victims of a complex commercial fraud in relation to their investments in six real estate development projects.

[9] Lee became involved with Lalu in or around July 2015. In November 2015, he was named CEO, and in February 2016, 2505805 Ontario Inc. ("250") (a company owned and controlled by Lee) entered into an agreement with Lalu (the "Consulting Agreement"), for the provision of the services of its principal, Lee, as CEO of Lalu. At the outset of the relationship between HZC and Lee, Lee was granted an ownership interest in what became Lalu and a seat on Lalu's board of directors. Lee directed that the shareholding and director's position be held by his

wife, Tongfang (Cathy) Jiang. Lee was terminated as Lalu's CEO in February 2018, and Jiang was terminated as director, although she continued to hold 25% of the shares of Lalu. Jiang and various corporations owned and controlled by Lee and Jiang are also defendants to the action, as are Domenic Di Gironimo, the former Chief Operating Officer and Acting Chief Financial Officer of Lalu, and certain corporations he owned and controlled.

[10] The application judge heard a motion in the HZC action for a *Mareva* injunction against various defendants to the action, including Lee, Jiang and Di Gironimo, and some of their companies. The record was voluminous, consisting of ten affidavits, transcripts from seven cross-examinations and numerous documents. The motion was dismissed, with reasons reported at *HZC Capital Inc. v. Lee et al.*, 2019 ONSC 4622. These reasons are important to this appeal, as they were relied on and informed the application judge's subsequent decision denying advance funding of Lee's legal costs.

[11] On the first part of the test for a *Mareva* injunction, the application judge was satisfied that the plaintiffs had a strong *prima facie* case against Lee for fraud in relation to his receipt of what he characterized as acquisition fees – amounts totaling $951,250 he had received from transaction proceeds in respect of a number of investments made by Lalu while he was the CEO. Lee, who never denied receiving the fees, asserted that he was entitled to receive these amounts under the terms of the Consulting Agreement, and that the Lalu board of directors

was aware of the fees, because he had disclosed them to Lei (Eric) Guo, one of the principals of Lalu. Guo denied such disclosure. Lalu's position was that Lee had no right under the Consulting Agreement to receive acquisition fees in respect of the investments Lee brought to Lalu, and that the fact that Lee had concealed his receipt of the fees from Lalu by channeling them through other parties, demonstrated that he knew he was not entitled to them. Both Lee and Guo filed affidavits and were cross-examined on the motion.

[12] After interpreting the Consulting Agreement and considering the evidence, the application judge stated, at para. 66:

> My conclusion that Lee had no right under the Lee Consulting Agreement to acquisition fees together with the evidence of the concealment of the receipt of such fees from Lalu are sufficient, in my view, to establish a strong *prima facie* case of fraud against Lee. In other words, I consider that Lalu is likely to succeed at trial in respect of its claim against Lee concerning his receipt of acquisition fees.

[13] By contrast, with respect to Di Gironimo, the application judge concluded that the evidence concerning Di Gironimo and his companies was "not sufficient, particularly given Di Gironimo's responses to Lalu's allegations, to convince [him] that the plaintiffs had a strong *prima facie* case against them": at para. 77. He added that, in his view, the plaintiffs had, at best, established a *prima facie* case against Di Gironimo.

[14] The application judge dismissed the *Mareva* injunction motion after concluding that the plaintiffs failed at the second step of the test: they had provided no evidence that there was a real risk of the defendants' assets being removed from the jurisdiction or otherwise being put out of reach of judgment. He also found that there was no evidence of irreparable harm and that the balance of convenience did not favour granting a *Mareva* injunction.

[15] At the end of the hearing on the *Mareva* injunction motion, the application judge heard Lee and Di Gironimo's applications for advance funding for their defence of the HZC action. In determining the applications for advance funding, the application judge referred to the test in *Cytrynbaum* and confirmed that, in order for an applicant to be denied advance funding, there must be a finding of a strong *prima facie* case of bad faith against him. Based on his findings on the *Mareva* injunction motion that the plaintiffs had established a strong *prima facie* case of fraud against Lee in connection with the acquisition fees, the application judge denied Lee's application for advance funding. Because the plaintiffs had established only a *prima facie* case against Di Gironimo, the application judge granted his application for advance funding.

IV. ISSUES ON APPEAL

[16] Lee advances three grounds of appeal. First, he contends that the application judge erred in interpreting the Consulting Agreement as not authorizing

him to be paid acquisition fees. Second, on the question of bad faith, he asserts that the application judge erred in his assessment of the evidence about whether Lalu knew he was receiving the fees and whether, by receiving the fees indirectly, he was concealing them from Lalu. Third, he submits that the application judge applied too low a legal threshold in rejecting his claim for advance funding of his legal costs. More specifically, Lee argues that the application judge incorrectly applied a "likely to succeed" standard to his determination of a strong *prima facie* case, rather than the "very likely" standard mandated by the Supreme Court in *R. v. Canadian Broadcasting Corp.*, 2018 SCC 5, [2018] 1 S.C.R. 196.

[17] I will address each ground of appeal in turn.

V. DISCUSSION

(1) Did the application judge err in his interpretation of the Consulting Agreement?

[18] The interpretation of a contract involves the application of contractual interpretation principles to the words of the written contract, considered in light of the factual matrix, and is therefore a question of mixed fact and law, which is entitled to deference absent a palpable and overriding error: *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633, at paras. 50-53. In the rare circumstances where an extricable error of law can be identified in the interpretation process, the standard of review is correctness. An extricable error of

law arises where an incorrect principle is applied, a required element of a legal test is ignored, or a relevant factor is ignored: *Sattva*, at para. 53.

[19] At the centre of the HZC action against Lee are various amounts Lee received, which the plaintiffs alleged were kickbacks and unauthorized payments he had sought to conceal from Lalu. Lee argued that he was entitled to receive certain amounts as "acquisition fees" in relation to the various development projects that Lalu acquired through his efforts. He claimed that the payment of acquisition fees is a standard industry practice and that the Consulting Agreement contemplated his receipt of such fees. Indeed, he had sourced at least one of the properties before joining Lalu. Lee relied on recital (h), which, after reciting that the retainer fee under the agreement was under-market for Lee's services, acknowledged that Lee had "the opportunity to make an indirect gain through an equity holding in the Partnership independent of [the] Agreement, and the Consultant and the Partnership are relying on the Services of the Consultant to realize such other gains". He also relied on s. 6.1 of the Consulting Agreement, which authorized Lee and 250 to hold an interest in any "other business, venture, investment or activity whether similar to or competitive with the Business of the [Lalu] Companies", and provided that this would not be a conflict of interest or breach of fiduciary or other duty.

[20] The application judge considered Lee's argument that the acquisition fees he received were authorized by the Consulting Agreement. At para. 57 of the

reasons on the *Mareva* injunction motion, he stated that, "[l]ooking at the Lee Consulting Agreement as a whole and also considering the context in which it was executed", he did not agree that it provided for or contemplated the payment of acquisition fees to Lee or 250 in respect of real estate deals that Lee sourced for Lalu. He rejected Lee's argument that recital (h) is a reference to Lee having an opportunity to make an indirect gain in respect of Lalu transactions. He concluded that the reference to "such other gains" referred to the equity gains both HZC and Lee, through Jiang's equity stake in Lalu, were expecting to realize from the real estate transactions Lee was supposed to bring to Lalu. He noted that this interpretation of recital (h) was consistent with the context of the Consulting Agreement, as Lee's compensation included not only the retainer fee but also any gain in Jiang's equity stake in Lalu. As for s. 6.1 of the Consulting Agreement, the application judge concluded that it permitted Lee to enter into real estate transactions with third parties, and did not speak to the real estate transactions he was required to bring to Lalu, or his compensation in respect of such deals. He also noted that there was no mention of acquisition fees in the compensation section of the Consulting Agreement.

[21] Lee argues that the application judge erred in concluding that he had no right to acquisition fees under the Consulting Agreement. Specifically, Lee takes issue with the application judge's conclusions that Jiang's equity stake in Lalu was a type of compensation under the Consulting Agreement, that the conflicts

acknowledgment under s. 6.1 did not speak to the real estate transactions that he was required to bring to Lalu, and that the Consulting Agreement as a whole and in context does not provide for or contemplate the payment of acquisition fees. Although he characterizes these as "palpable and overriding errors" in the "findings" of the application judge, Lee is simply challenging the application judge's interpretation of the Consulting Agreement, and in particular the meaning he attached to the various provisions relied on by Lee. In oral argument, Lee's counsel asserted that the application judge committed an extricable legal error by failing to give proper consideration to the relevant provisions of the Consulting Agreement and in failing to give full force and effect to the agreement as a whole. He also argued that the application judge's interpretation of the Consulting Agreement would lead to a commercial absurdity: that Lee would be incentivized to bring real estate deals to other parties, rather than to Lalu.

[22] I disagree. Contrary to Lee's arguments, the application judge considered the very provisions Lee relied on in the light of the entire Consulting Agreement and its purpose. The application judge interpreted the plain meaning of the Consulting Agreement as not authorizing Lee to receive acquisition fees in respect of properties he sourced for Lalu. The application judge considered the context, including the relationship between the parties, when he observed that Lee's compensation included not only the retainer fee provided for in the Consulting Agreement but also any gain in Jiang's equity stake in Lalu. This conclusion is fully

supported by the evidence, including the terms of the Unanimous Shareholders' Agreement that speak to such gains.

[23] Lee has demonstrated no reversible error in the application judge's rejection of his argument that the Consulting Agreement authorized his receipt of acquisition fees in respect of the investments he sourced for Lalu.

(2) Did the application judge err in his assessment of the evidence on whether Lalu knew of the acquisition fees and whether Lee had concealed the acquisition fees from Lalu?

[24] Lee submits that the application judge erred in principle in making a credibility finding against him on the issue of whether Lalu knew about the acquisition fees and whether he had concealed the fees from Lalu. In particular, Lee argues that the application judge erred in accepting Guo's evidence that he was not aware of Lee's receipt of acquisition fees and rejecting Lee's evidence to the contrary.

[25] In oral argument, Lee's counsel characterized Guo's evidence as containing an "internal inconsistency": Guo admitted under cross-examination that he knew that Lee had sourced various deals, that there was an "industry practice" to pay acquisition fees, and that the pro formas for the various properties purchased by Lalu contained line items for acquisition fees. With these admissions, how could the application judge accept Guo's evidence that he was unaware that Lee would be receiving acquisition fees?

[26] First, I note that Guo's cross-examination evidence is not entirely as summarized by Lee's counsel. While Guo acknowledged that Lee had sourced various deals for Lalu, he insisted that Lee was doing this in his role as consultant and CEO of Lalu. He acknowledged that there was an industry practice for the person who sources a deal to receive an acquisition fee "if it is external, independent and we had an agreement". Further, he stated that the fact that acquisition fees were included as a line item in a pro forma did not mean that they were authorized to be paid. Contrary to Lee's submission, Guo's evidence does not lead to the necessary inference that Lalu must have known that Lee was receiving acquisition fees. Moreover, Lee does not rely on any other alleged corroboration of his statement that he told Guo and others at Lalu that he was receiving acquisition fees, or for that matter, that Lalu authorized such fees to be paid to him.

[27] Second, I do not agree with Lee's submission that the application judge rejected his evidence on the basis of a preference for the testimony of Guo. Rather, the application judge recognized that there was a conflict between the evidence of Lee and Guo that could not be determined on the *Mareva* injunction motion. Nevertheless, he concluded, at para. 62 of the reasons on the *Mareva* injunction motion, that Lee's evidence – that he believed he received payments as acquisition fees in good faith with the knowledge of Guo and others – was "diminished" by

"evidence of his steps to conceal his receipt of the acquisition fees from Lalu", when the fees were not paid directly to Lee or a company he controlled.

[28] In oral argument, Lee's counsel acknowledged that the application judge was entitled to take into consideration the evidence that he received the payments indirectly through corporate entities in which he did not hold an interest. Indeed, this was important evidence that undermined the plausibility of Lee's claim that the acquisition fees were known to Lalu (and presumably approved by Lalu notwithstanding the absence of any corroborating evidence). And, contrary to Lee's argument, the application judge did not engage in circular reasoning when he relied on the evidence of the indirect payment of fees. Rather, it was evidence that itself suggested that Lee was concealing the payments, especially in light of Lee's admissions that the fees were not paid to him directly or in a way that would enable others at Lalu to understand that he was receiving them, and the failure to offer any real explanation for the indirect path of the funds. As the application judge queried, "[i]f [Lee] told Guo about the acquisition fees, why cause them to be paid to him indirectly?": at para. 62.

[29] Lee has demonstrated no error in the application judge's assessment of the evidence about whether Lalu knew that he was receiving acquisition fees and whether, by receiving the fees indirectly, he was concealing the fees from Lalu.

(3) Did the application judge apply the wrong legal test?

[30] Finally, Lee argues that the application judge erred in law in adopting too low a threshold for refusing him advance funding. He points to para. 66 of the reasons on the *Mareva* injunction motion, where the application judge, after stating his conclusion that there was a strong *prima facie* case of fraud against Lee, continued: “In other words, I consider that Lalu is likely to succeed at trial in respect of its claim against Lee concerning his receipt of acquisition fees.”

[31] Lee submits that, while the application judge correctly identified the test as whether there was a “strong *prima facie* case of fraud”, he ought to have been satisfied that Lalu was “very likely” to succeed at trial, or that Lalu’s case was “unusually strong and clear”. According to Lee, the standard of “likely to succeed” places the bar too low.

[32] Lee refers to and relies on a formulation of the test for a strong *prima facie* case set out by the Supreme Court in its 2018 decision in *Canadian Broadcasting Corp.* That case involved an application for an interlocutory mandatory injunction in the context of a citation for contempt, after the Canadian Broadcasting Corporation (the “CBC”) refused to remove information from its website identifying a victim, allegedly contrary to a publication ban, under s. 486.4(2.2) of the *Criminal Code*, R.S.C. 1985, c. C-46, that was issued after the CBC had posted the information. Brown J., writing for the court, confirmed that the test for an interlocutory mandatory injunction requires, at the first stage, that the applicant

demonstrate a strong *prima facie* case, and not simply a "serious issue to be tried" (which was the threshold that had been applied by the courts of some Canadian jurisdictions at the time). After setting out the various formulations of what a strong *prima facie* case entails in a number of interlocutory mandatory injunction cases, Brown J. noted, at para. 17, that "[c]ommon to all these formulations is a burden on the applicant to show a case of such merit that it is very likely to succeed at trial". He then set out the test, at paras. 17 and 18, in the following way: "[U]pon a preliminary review of the case, the application judge must be satisfied that there is a *strong likelihood* on the law and the evidence presented that, at trial, the applicant will be ultimately successful in proving the allegations set out in the originating notice" (italics in original; underlining added).

[33] In the context of an application under s. 124 of the CBCA, the "strong *prima facie* case" requirement for denying advance funding on the basis of bad faith recognizes that there is a presumption of good faith, and that funding would ordinarily be available. It recognizes that the assessment of bad faith is being made at an interlocutory stage, on the basis of evidence available at that stage, and that it will not be binding in the final disposition of the matter, when other evidence and arguments may be before the court. Sharpe J.A. explained in *Cytrynbaum* that "[b]y its very nature, a request for advance funding invites a preliminary assessment of the merits of the case but one that is not final and that does not bind the parties for the purposes of the [corporation's] action": at para. 53. He noted

that the strong *prima facie* case test is a “stringent test”, and that, although the applicant for advance funding would be presumed to have acted in good faith, there is a possibility they would be denied funding “when there is strong evidence of bad faith”: at para. 56.

[34] I need not decide whether the “strong *prima facie* case” test that applies in the context of s. 124 of the CBCA has been elevated by the strong language used by the Supreme Court in *Canadian Broadcasting Corp*. to describe the “strong *prima facie* case” standard that applies where interlocutory mandatory injunctions are sought. In citing *Cytrynbaum*, the application judge recognized that the strong *prima facie* case test he was to apply was a “stringent” test, language that is consistent with the standard expressed in *Canadian Broadcasting Corp.* The application judge also gave compelling reasons that support the strong likelihood that Lalu’s action will succeed. It is clear he understood the difference between a strong *prima facie* case and a *prima facie* case, which informed his decision to order advance funding to Di Gironimo. I am persuaded that, whether or not the application judge was required to ensure that Lalu met the “strong *prima facie* case” test expressed in *Canadian Broadcasting Corp.*, he applied a commensurate standard. In the circumstances, I do not regard the application judge’s statement in his reasons on the *Mareva* injunction motion that it was “likely” rather than “very likely” that Lalu would succeed at trial as undermining the stringent test that he applied and his determination, at para. 20 of his reasons on the application for

advance funding, that the “evidence against [Lee] established a strong *prima facie* case of fraud”.

[35] I would therefore reject this ground of appeal. The application judge did not apply too low a threshold in denying Lee advance funding.

VI. CONCLUSION

[36] *Cytrynbaum* instructs that, in an application for advance funding, although there is a presumption of good faith, the corporation can lead evidence of the applicant’s bad faith. It is necessary on such an application to conduct a preliminary assessment of the merits of the allegation of bad faith. The fact that a final determination cannot be made does not prevent the court from conducting the required analysis.

[37] In this case, the application judge conducted such a preliminary assessment in the context of the *Mareva* injunction motion, when he concluded that Lalu had established a strong *prima facie* case of fraud in connection with Lee’s receipt of acquisition fees. He interpreted the Consulting Agreement as not entitling Lee to acquisition fees. There was no reversible error in his interpretation. And, although there was a conflict between Lee’s evidence that he had informed Guo, and through him Lalu, that he was receiving the acquisition fees, and Guo’s denial, there was other evidence that Lee was acting fraudulently: the fact that Lee received the payments through corporations in which he held no interest, and the

fact that he offered no real explanation for doing this, were consistent with an effort to conceal the payments from Lalu.

[38] This is not a case where the evidence was evenly balanced, or where there was only some evidence to overcome the presumption of good faith on the part of Lee. There was "strong evidence" of bad faith in this case, and no error in the application judge's analysis and conclusion, based on the evidence before him, that there was a strong *prima facie* case of fraud in respect of Lee's receipt of acquisition fees.

VII. DISPOSITION

[39] For these reasons, I would dismiss the appeal, with costs to Lalu in the agreed amount of $18,500, inclusive of disbursements and HST.

Released: June 3, 2020 ("S.E.P.")

"K. van Rensburg J.A."
"I agree. S.E. Pepall J.A."
"I agree. David M. Paciocco J.A."