

Serving two masters

A recent case shows the importance of fiduciary obligations owed by lawyers to clients. Suzana Popovic-Montag explains



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'Even in situations where a well-drafted retainer agreement narrows the scope of the parties' roles, the duties of loyalty and avoidance of conflict of interest still exist and can extend beyond the terms of the retainer.'

In the decision of *3464920 Canada Inc v Strother* [2007] a full panel of the Supreme Court of Canada underscored the importance of fiduciary obligations in the context of a solicitor-client relationship. In the 5-4 decision released on 1 June 2007, the majority of the Court upheld the finding of the British Columbia Court of Appeal that the defendant solicitor acted in a conflict of interest and breached his fiduciary duties to his former client. As a consequence, the solicitor was ordered to account and ultimately disgorge the profits he earned as a result of having acted improperly.

Facts of the case

The defendant, Robert C Strother, was a tax partner at the law firm of Davis & Company. He was the solicitor for Monarch Entertainment Corporation – which subsequently became 3464920 Canada Inc, the named claimant in the case – which devised and marketed tax shelter investments related to the film production industry in Canada.

In 1996 and 1997 the firm's engagement was expressed in written retainer agreements. From October of 1996 the retainer between Monarch and Davis expressly prohibited Davis from acting for others in relation to these tax shelter schemes. The written retainer terminated at the end of 1997, along with the exclusivity clause, and it was not renewed. Monarch continued, however, to be a client of the firm and, in particular, of Strother, in 1998 and 1999.

Towards the end of 1996 the tax law changed in Canada, and the tax shelters relied upon by Monarch for its success were eventually eliminated. As a result of Strother's advice that there was no way to avoid the new tax rules, Monarch took steps to wind down its business. Several employees were laid off, including its former chief financial officer, J Paul Darc.

During 1998 and 1999 Monarch requested Strother's advice on the availability of other business opportunities in light of the tax law changes but not in respect of tax shelter schemes directly.

In late 1997 or early 1998 Darc approached Strother to discuss a new tax shelter business that might be accepted by the Canada Revenue Agency (CRA), notwithstanding the tax law changes. Strother agreed to assist Darc and drafted a proposal to CRA for approval. In exchange for volunteering his services, it was agreed that Strother would receive 55% of the first \$2m of profit, should the tax ruling be granted, and 50% thereafter. Ultimately Darc obtained a favourable advance ruling allowing the tax shelter scheme, related to film production, to continue.

A new company was eventually formed by Darc, called Sentinel Hill Entertainment Corporation. In accordance with their agreement, Strother received a substantial share of the company and a direct financial interest in his client's business. At no time, however, did Strother tell Monarch about the possibility of a revival in the film production services business as a result of the favourable tax ruling to its competitor, Sentinel. The ruling was issued on 6 October 1998.

In March 1999, on the advice of Davis' managing partner, Strother ultimately resigned (as a result of the conflict of interest) and joined Darc and Sentinel as a 50% shareholder.

Upon learning of the CRA ruling that allowed the tax shelter schemes to continue and Strother's direct involvement with Sentinel, Monarch sued Strother and Davis for breach of fiduciary duty and breach of confidence.

As a result of the allegations made, the issues before the Court were four-fold:

- (1) Did Strother and/or Davis breach a fiduciary duty owed to Monarch by

accepting Darc/Sentinel as a new client?

- (2) Did Strother breach a fiduciary duty to Monarch by accepting a personal financial interest in Sentinel, and if so, was Davis also liable for that breach?
- (3) Did Strother wrongly use for his own and/or Sentinel's benefit confidential information belonging to Monarch?
- (4) If one or more of the above issues were resolved in favour of Monarch, what remedies lay against Strother and/or Davis and the various entities who profited by the default, if any, from 1998 to the present?

The finding at trial

Lowry J dismissed Monarch's claim at first instance. The trial judge found that Strother's fiduciary obligations to Monarch were defined by the scope of the retainer (the written retainer ended in 1997). Lowry J held further that Monarch's confidential information was not disclosed or used by anyone in Sentinel.

According to the trial judge, the Davis retainer in 1998 was very different from what it had been in 1997. There was, for example, no longer a provision of exclusivity of only acting for Monarch. In addition, Strother was not obliged to provide any advice to Monarch that was not specifically sought and that he agreed to give. Consequently, Lowry J held that Strother was free to be consulted by Darc and Davis was free to act for Sentinel thereafter.

Notably, Lowry J found that solicitors do not generally carry an ongoing obligation to alter advice given under a concluded retainer because of a subsequent change of circumstances, provided, of course, that the advice, when given, was correct.

Not surprisingly, Monarch appealed.

The finding on appeal

The appeal was allowed unanimously by the British Columbia Court of Appeal, and Strother's conduct was found to have constituted a breach of fiduciary duty in the solicitor-client relationship. According to Newbury J, Strother was in a position of conflict in two senses: first, he was in a conflict of duty or loyalty between two current clients, Monarch and Sentinel; secondly

there was a conflict of interest between Strother himself personally and Monarch, his client through 1998.

The Court of Appeal noted that, although the terms of the exclusivity arrangement ended in 1997, the solicitor-client relationship between Monarch and Davis continued, albeit without the negotiation of a new written agreement. Since Monarch was still a client of the firm, Strother had an ongoing duty to advise it of any developments in the field even under the terms of the narrow 1998 retainer. As a result, Strother ought to have advised Monarch of the possibility that the tax

Binnie J observed that when a lawyer is retained by a client, the scope of the retainer is governed by contract. The parties can agree as to the nature and extent of the services to be provided by the lawyer, but this contractual solicitor-client arrangement is still overlaid with certain fiduciary responsibilities.

scheme that was core to its business might be revived or, at a minimum, that Monarch should seek advice elsewhere.

Consequently, the Appeal Court disagreed with the trial finding that Strother's duty did not extend beyond what the firm's retainer required. Rather, the moment that Strother and Darc entered into their agreement in January 1998, Strother was in a position of personal conflict – it was suddenly in his personal interest, found the Court, to ensure that Monarch did not learn what he knew as a result of the CRA ruling. By putting his own financial interest in one client, Sentinel, ahead of his duty to another, Monarch, Strother breached his fiduciary duty of loyalty. As a result, the Court of Appeal held that Strother was:

... required to account for and disgorge to Monarch all benefits, profits, interests and advantages he ha[d] received or which he [might] hereafter be entitled to receive, directly or indirectly ... from or through any of the Sentinel Hill Entities.

As for the allegation that Davis ought to be vicariously liable for its partner's actions, Newbury J found the firm to be an innocent party that had not received any of the profits resulting from the wrong committed by Strother.

As a consequence, she did not order Davis to account for the profits and benefits received (or receivable) by Strother from Sentinel. She did, however, require the firm to disgorge the profits it earned in the form of legal fees as a result of acting for Sentinel, in conflict with its duty to Monarch, from the beginning of January 1998. This vicarious liability for Strother's tortious conduct was imposed by virtue of British Columbia's Partnership Act 1996.

Strother and Davis then appealed, and Monarch cross-appealed, to the Supreme Court of Canada. The basis of Monarch's cross-appeal was that the

Court of Appeal had dismissed Monarch's appeal of the trial judge's rejection of its claim that the fees it had paid to Davis between 1993 and 1998 ought to be returned to it. The Court did, however, order that Davis return to Monarch all fees paid by it from 1 January 1998 onwards (para 33). The appeals were ultimately allowed, in part, but Monarch's cross-appeal was dismissed.

The Supreme Court decision

Nature of the solicitor-client relationship

Binnie J commenced his reasons on behalf of the majority of the Supreme Court of Canada by reiterating some of the fundamental tenets of the solicitor-client relationship. He started with the general proposition that:

A fundamental duty of a lawyer is to act in the best interest of his or her client to the exclusion of all other adverse interests, except those duly disclosed by the lawyer and willingly accepted by the client.

He held that fiduciary duties 'provide the framework... within which a particular contractual mandate is to be carried out'. This is because, generally speaking, when a lawyer is retained by a client, the scope of the retainer is governed by

contract. The parties can agree as to the nature and extent of the services to be provided by the lawyer to the client. However, this contractual solicitor-client arrangement is still overlaid with certain fiduciary responsibilities.

Binnie J confirmed that an important element of the duty of loyalty is the avoidance of conflicts of interest. Indeed, according to *R v Neil* [2002] 'loyalty includes putting the client's business ahead of the lawyer's business'. Here, however, the Court found that Davis' position:

... was compromised by the personal conflict of a lawyer (Strother) who, contrary to the instructions of Davis' managing partner, contracted for a personal financial interest in one client (Sentinel) whose interest he then preferred over another client (Monarch) who now sues for compensation.

As a consequence the Supreme Court identified the issues before it as:

- whether the fiduciary obligations were sufficiently limited by the

scope of the 1998 retainer, so as to afford Monarch no relief; or

- whether, on the contrary, the fiduciary duty was broader than the trial judge thought and was breached, either by Strother or Davis or both; and
- if so, what the appropriate remedy would be.

In analysing the scope of the contractual 1998 retainer, the Supreme Court held that:

Where a retainer has not been reduced to writing (as was the case with the 1998 retainer here) and no exclusions are agreed upon, as here, the scope of the retainer may be unclear. The court should not in such a case strain to resolve the ambiguities in favour of the lawyer over the client...

Monarch's tax business was in a jam. Strother was still its tax lawyer. There was a continuing 'relationship of trust and confidence'. Monarch was dealing with professional advisors, not used car

salesmen or pawnbrokers, whom the public may expect to operate on the basis of 'didn't ask, didn't tell', and who collectively suffer a corresponding deficit in trust and confidence. Therein lies one of the differences between a profession and some businesses.

Having expanded the scope of the 1998 retainer, the Court then turned to examine whether the retainer agreement had been breached. It acknowledged that, generally speaking, a lawyer does not have a duty to alter a past opinion in light of a subsequent change of circumstances. The Court reasoned that a legal opinion speaks as of its date – '[a] client cannot assume that the lawyer's opinion has an indefinite shelf life'. There are, however, exceptions to the general rule, in which case the parameters of a lawyer's duty to advise will depend upon the particular circumstances. The Court noted that Monarch's retainer of Davis was not a concluded retainer: even though the written agreement had come to an end in 1997, the solicitor-client relationship continued throughout 1998 and 1999. The Court concluded that:

Of course, it was not open to Strother to share with Monarch any confidential information received from Darc. He could nevertheless have advised Monarch that his earlier view was too emphatic, that there may yet be life in a modified form of syndicating film production services expenses for tax benefits, but that because his change of view was based at least in part on information confidential to another client on a transaction unrelated to Monarch, he could not advise further except to suggest that Monarch consult another law firm. Moreover, there is no excuse at all for Strother not advising Monarch of the successful tax ruling when it was made public in October 1998. As it turned out, Monarch did not find out about it until February or March 1999.

As a result, the Court ultimately found that Davis (and Strother) failed to provide candid and proper legal advice to Monarch in breach of the 1998 retainer. Binnie J further held that:

If this were a contract case, I would have no hesitation in holding both Davis and Strother liable for their failure to provide the timely and candid advice they were contractually obliged to give within the

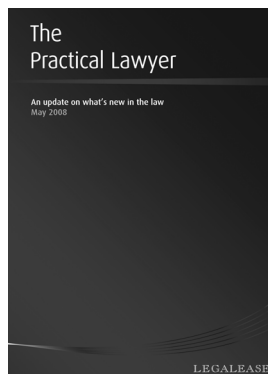
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scope of their 1998 retainer. However, Monarch cannot succeed in a claim for damages for breach of the contract of retainer because (as found by the trial judge) it did not establish any damages flowing from the alleged breach. The issue therefore moves to fiduciary duties.

The claim for disgorgement

Rather than claim for damages for breach of contract, Monarch sought a disgorgement by Strother, Darc, Sentinel and Davis of the money they made between 1998 and 2001 as a result of the breach of Strother's and Davis' fiduciary obligations to it. This equitable remedy, noted the Court, arose as a result of the fact that Strother ought not to have accepted a personal financial interest in Sentinel. It was reasoned that, because he benefited from this conflict of interest, he should be required to disgorge consequential profits to Monarch. It was that personal financial interest that came into conflict with Strother's fiduciary duty to Monarch to avoid conflicts of interest in performing the contractual obligations assumed under the 1998 retainer.

In the course of its analysis, the Court examined the nature of the remedy of disgorgement of profit and noted that it could serve two equitable purposes. The first was a prophylactic purpose, its objective being to preclude a fiduciary from being swayed by considerations of personal interest. The second potential purpose was restitutionary, to restore to the beneficiary profit which properly belonged to the beneficiary, but which had been wrongly appropriated by the fiduciary in breach of its duty. In the case before it, noted the Court, the restitutionary purpose was not an issue.

In the end, the Supreme Court ordered Strother to account to Monarch for all the personal benefits he gained from Sentinel, and all earnings he made as a partner of Davis, from 1 January 1998 to 31 March 1999, the date that both Strother and Monarch severed their relations with Davis. The Court reasoned that Strother could not 'be permitted to pocket the money thus derived from a personal interest in conflict with his fiduciary duty'. After 31 March, however, the conflict was 'spent' and, according to

the Court, to require a disgorgement of profits after that date would render the remedy to account punitive rather than prophylactic. To this extent, then, the result was different from the finding of the Court of Appeal.

Notably, in coming to its conclusion, the Court did not require Davis to return the fees paid to it from Monarch in 1998 or 1999, thus overturning the Court of Appeal to this extent. The Court reasoned that Davis committed no breach of fiduciary duty to Monarch, and was not responsible for Strother's breaches. As a result, no order for equitable relief ought

Strother's problem arose because despite his duty to an existing client, Monarch, he acquired a major personal financial interest (unknown to Davis) in another client, Sentinel, in circumstances where his prospects of personal profit were enhanced by keeping Monarch on the sidelines.

As a result, the Supreme Court dismissed Strother's appeals against the finding that he acted in a conflict of interest, but limited the duration of time during which he was required to account. A reference was ultimately

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to be made against Davis in this regard. According to the Court, whatever financial arrangement Strother had with Darc and Sentinel, Davis was not aware of it or a party to it. The fact that Monarch could not establish ultimately that other partners of Davis had knowledge of Strother's conflict was important to the assessment of their potential liability as fiduciaries. Indeed, the Court found that the Davis firm was as much an innocent victim here as was Monarch. Having said that, the Supreme Court did find Davis to be vicariously liable for Strother's wrongdoing (for the sum ultimately found to be due by Strother to Monarch) on the basis of the British Columbia Partnership Act, s12 of which provides that:

If, by any wrongful act or omission of any partner acting in the ordinary course of the business of the firm or with the authority of his or her partners, loss or injury is caused to any person who is not a partner in the firm or any penalty is incurred, the firm is liable for that loss, injury or penalty to the same extent as the partner so acting or omitting to act.

As part of its analysis, the Court found that Davis was free to take on Darc and Sentinel as new clients in 1998 (once the exclusivity arrangement with Monarch had expired) and that, in doing so, it was not acting in conflict with its ongoing solicitor-client relationship with Monarch:

directed to determine the appropriate calculation of Strother's profit (both directly and indirectly) and Monarch was awarded a monetary judgment against Strother in that amount.

Conclusion for UK practitioners

As a result of this decision of the highest court in Canada, all practitioners everywhere are reminded of the importance of fiduciary obligations in a solicitor-client relationship. Even in situations where a well-drafted retainer agreement narrows the scope of the parties' roles, the duties of loyalty and avoidance of conflict of interest still exist and can extend beyond the terms of the retainer. And in situations where the retainer has not been reduced to writing, and its scope is thus unclear, we are cautioned that we should not expect the court to resolve ambiguities in favour of the lawyer over the client.

We are, however, comforted by the acknowledgement that, by and large, lawyers do not have a duty to alter a past opinion in light of a subsequent change of circumstances. Having said that, we are also reminded that partners may be held vicariously liable for the actions of their other partners, even in situations where they are completely innocent and unaware.

This, of course, places an onus on firms to scrutinise the activities of their partners, or face liability for having failed to do so. ■

3464920 *Canada Inc v Strother*
[2007] SCC 24
R v Neil
[2002] 3 SCR 631