

Expulsion of a partner can result in expectation and aggravated damages

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Introduction

In *Tim Ludwig Professional Corp v BDO Canada LLP* the Court of Appeal for Ontario held that damages for lost profits may be awarded where a partner is wrongfully expelled from the partnership, and that a court can award aggravated damages where the partner is expelled in bad faith.⁽¹⁾ To expel a partner properly, the partnership must follow:

- the terms of the partnership agreement;
- Ontario's Partnership Act;⁽²⁾ and
- the common law.

To properly trigger the expulsion provisions in a partnership agreement, the evidence considered by the policy board must support a reasonable conclusion that it is not in the partnership's best interest for a particular partner to remain.

Facts

The plaintiff was a chartered accountant and trustee in bankruptcy, as well as a partner of the defendant for 22 years. The partnership agreement between the parties set out the terms of the partnership and provided for the departure of each partner. It provided for:

- a compulsory retirement date; and
- a process for the requested resignation of a partner before the compulsory retirement date.

The requested resignation provision required the policy board (consisting of seven elected members of the partnership), having determined that it was not in the best interest of the partnership for the partner to remain a partner, to give notice to the partner in writing, at which point the partner was deemed to have resigned.

The plaintiff was called into a meeting with two partners and informed that:

- he would have to retire;
- the chief executive officer (CEO) required that he retire;
- the decision to require him to retire had nothing to do with his performance; and
- the non-compete clause in the partnership agreement would be invoked against him.

While the defendant deposed that the plaintiff's performance was also a reason for the resignation, the defendant provided the plaintiff with no particulars relating to his alleged underperformance.

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Following the meeting with the plaintiff, the defendant had announced the plaintiff's retirement to the firm. Sometime thereafter, the defendant invoked the partnership agreement as a ground to justify requiring the plaintiff to retire early. Three months later, the policy board of the partnership unanimously voted to request the plaintiff's resignation, ostensibly following the requested resignation process in the partnership agreement.

Lower court proceedings

The plaintiff brought a claim for damages resulting from breach of the partnership agreement, and successfully obtained summary judgment under Rule 20 of Ontario's Rules of Civil Procedure.(3)

The motion judge awarded the plaintiff \$1,233,739 in damages for loss of profits which he would have received under the firm's profit sharing agreement had he worked to his compulsory retirement date, and \$61,191 for an additional retirement benefit that he would have received had he retired on the date set out under the partnership agreement. The motion judge also awarded the plaintiff \$100,000 in aggravated damages for the harm to his reputation caused by his expulsion. The defendant did not contest the plaintiff's analysis on damages or lead evidence to contradict the plaintiff on this point.

Analysis

The court of appeal upheld the motion judge's decision, as it held that the firm had breached the partnership agreement.

Partnership law

Partnership law in Ontario is governed by a combination of contract, statute and common law.

Ontario's Partnerships Act:

- sets out the statutory framework for partnership law;
- requires express agreement between the partners in order to confer a power of expulsion;(4) and
- expressly provides that the rules of equity and of common law applicable to partnerships continue in force, insofar as they are inconsistent with the express provisions of the Partnerships Act.(5)

The applicable common law principles are as follows:

- An expulsion provision in a partnership agreement will be construed strictly.
- Partners are fiduciaries among themselves and therefore the utmost good faith is owed from every member of a partnership towards every other partner.
- Where a discretion is conferred on the management or on a majority of partners, a partner will normally be entitled to expect that it will be exercised rationally, in good faith and not arbitrarily or capriciously.

Partnership agreement

To properly trigger the expulsion provisions in a partnership agreement, the evidence considered by the policy board must support a reasonable conclusion that it is not in the partnership's best interest for a particular partner to remain. This ensures that the policy board's decision is made:

- in good faith;
- in the partnership's best interest; and
- not arbitrarily or capriciously.

The focus is not on the nature of the ground on which the board relies to request a retirement, but rather on the existence of a ground that could reasonably justify a partner's expulsion.

There was no evidentiary basis on which the court could conclude it was in the best interest of the partnership to request the plaintiff's retirement. The reasons given by the policy board related to the

economic climate and the firm's economic circumstances. While the plaintiff was told that his underperformance was a factor, both the motion judge and the court of appeal found that these were bald assertions. The defendant did not lead evidence from the CEO or any member of the policy board as to the reasons for the plaintiff's termination.

In addition, the court of appeal held that it was clear from the evidence that the decision to expel the plaintiff was not made by the policy board as required under the partnership agreement. The plaintiff was told that the decision had been made by the CEO. This supported the inference that the policy board's decision was predetermined. Therefore, there was no evidence that the policy board had determined in the best interest of the partnership as required under the partnership agreement.

Damages

The court of appeal did not interfere with the motion judge's award of expectation damages and aggravated damages, or their quantum. The defendant made submissions in respect of the damages issue for the first time on appeal, which the court did not accept. However, the court of appeal noted that the availability of damages arose from the particular facts of the case, such as the motion judge's findings that the plaintiff could not feasibly return to the firm, and that the non-compete clause in the partnership agreement effectively prevented the plaintiff from mitigating his losses. It is therefore not the case in every situation that the measure of damages for breach of a partnership agreement is the amount of lost profits for the life of the partnership.

More interestingly, the court of appeal affirmed that aggravated damages are available for breach of a partnership agreement, following principles of damages arising from employment contracts. In *Keays v Honda Canada Inc*⁽⁶⁾ the Supreme Court of Canada confirmed that damages for intangible harm arising from breach of an employment contract can be awarded following the general principle of contractual damages, as an employment contract creates an expectation that the employer will be "candid, reasonable, honest and forthright with its employees",⁽⁷⁾ including in the manner of dismissal. The court of appeal explained that intangible damages for bad faith in the manner of dismissal of employment are therefore not true 'aggravated damages' (which require a separately actionable tort), but arise from breach of the expectation that an employer will act in good faith in the manner of dismissal.⁽⁸⁾

The court of appeal recognised that partners are not employees and are governed by a separate legal regime at common law and under the Partnerships Act.⁽⁹⁾ However, the court of appeal held that the reasoning in *Keays*,⁽¹⁰⁾ in combination with the duty of good faith owed under partnership law, suggests that damages for intangible harm are available under the general principle of contract damages. The intangible harm resulting from a bad-faith expulsion is reasonably foreseeable and flows from the breach of the implied term of good faith present in every partnership agreement.⁽¹¹⁾

Comment

This decision is significant because it affirms that aggravated damages are available for breach of a partnership agreement. As noted above, however, the firm offered no evidence to rebut the plaintiff's analysis on damages. Therefore, on different facts this award may be easily distinguished.

Expulsion provisions in partnership agreements must be interpreted and applied alongside the requirements under common law, particularly the requirement for the decision makers in the partnership to consider evidence that justifies the exercise of the power to expel.

For further information on this topic please contact [Norm Emblem](#) or [Aoife Quinn](#) at Dentons Canada LLP by telephone (+1 416 863 4511) or email (norm.emblem@dentons.com or aoife.quinn@dentons.com). The Dentons Canada LLP website can be accessed at www.dentons.com.

Endnotes

(1) 2017 ONCA 292

(2) RSO 1990, cP5.

(3) Reg 194, which provides for summary determination of a claim if there is "no genuine issue requiring a trial".

(4) *Supra* note 2, Section 25.

(5) *Supra* note 2, Section 45.

(6) 2008 SCC 39.

(7) *Ibid* at para 58.

(8) *Supra* note 1 at para 63.

(9) *Supra* note 2.

(10) *Supra* note 5.

(11) *Supra* note 1 at para 69.

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