

CITATION: Mady Development Corp. v. Rossetto, 2012 ONCA 31
DATE: 20120117
DOCKET: C53884

COURT OF APPEAL FOR ONTARIO

Doherty, Armstrong and Hoy JJ.A.

BETWEEN

Mady Development Corp., D. Mady Investments Inc. and Mady Contract Division Ltd.

Appellants (Respondents in Appeal)

and

Leonard “Len” Rossetto , 2034167 Ontario Ltd. and EMIK A.K.A. Emma Aboulian

Respondents (Appellant in Appeal)

Gregory M. Sidlofsky, for the appellant

Myron W. Shulgan, Q.C., for the respondents

Heard: December 1, 2011

On appeal from the order of Justice Beth A. Allen of the Superior Court of Justice, dated November 17, 2010, with reasons reported at 2010 ONSC 6323.

Hoy J.A.:

[1] Leonard Rossetto appeals from the November 17, 2010 order of the appeal judge, allowing an appeal from an arbitrator’s decision.

[2] There are two issues to be decided on this appeal:

- (1) Did the appeal judge err in holding that there is an overriding principle which disentitles a fiduciary employee to any bonus in respect of a period of time in which he acted in breach of his fiduciary duty?
- (2) If so, should the arbitrator's award granting Mr. Rossetto the bonuses earned as part of his employment be reinstated?

[3] For the reasons that follow, I would allow the appeal and restore the arbitrator's award.

I. OVERVIEW

(1) Background

[4] Mr. Rossetto was employed as an executive with Mady Development Corp., D. Mady Investments Inc. and Mady Contract Division Ltd. (collectively, "Mady"). Between September 3, 2007 and November 15, 2007, he diverted labour and materials, and used Mady's funds to renovate his house. Mady discovered his wrongdoing, and terminated his employment on December 12, 2008. Mady subsequently sued Mr. Rossetto for damages for conversion, breach of employment contract, unjust enrichment and breach of fiduciary duty. Mr. Rossetto counterclaimed in respect of his bonuses for 2007 and 2008. The parties ultimately submitted the dispute to arbitration.

[5] Mady framed its arbitration claim in relation to the diversion of resources as a claim for breach of fiduciary duty. It took the position that because Mr. Rossetto was terminated for cause, Mady was not obligated to pay his bonuses.

(2) The arbitrator's award

[6] The arbitrator awarded Mady damages totalling \$546,452:

- \$315,452 in respect of the misappropriated labour, materials and funds; and
- \$231,000 to compensate for the delay to one of Mady's legitimate projects occasioned by Mr. Rossetto's diversion of resources and attention to his home renovations.

[7] In his reasons, the arbitrator noted that "the evidence was far from "hard" as to the actual costs" (associated with Mr. Rossetto's misappropriation), and "that there were several major external factors that led to the substantial delay".

[8] The arbitrator found, at page 2 of his decision, that Mr. Rossetto was a member of Mady's small executive group and a trusted individual within the Mady organization. Pursuant to his employment contract, Mr. Rossetto was entitled to an annual bonus equal to 30 per cent of Mady's profits after overhead. The arbitrator also found, at page 5 of his decision, that the effect of this net profit based bonus was that the relationship between Mady and Mr. Rossetto would operate as a "true partnership".

[9] The arbitrator noted at page 17 that:

One could also argue that as Rossetto was a Vice-President of Mady Contract, he was an officer of the Company and therefore owed the Company a fiduciary duty, of which he was in breach. I think it is appropriate, however, in this case to treat Rossetto as an employee whose terms of employment were set out in the contract, as amended, between himself and Mady.

[10] The arbitrator found that “Rossetto’s entitlement to an annual bonus was clearly an integral part of his contract with Mady from the very first day he entered into his employment.” Relying on *Sibilia v. G.P. Page Publications Ltd.*, 1983 CarswellOnt 1817 (H.C.J.), the arbitrator concluded that a dishonest dismissed employee is entitled to be paid for the work that he has done. He distinguished *Clark (c.o.b. as Intelligent Workbench Corp.) v. Coopers and Lybrand Consulting Group* (1999), C.C.E.L. (3d) 188 (S.C.), *aff’d* (2002), 163 O.A.C. 1 (C.A.). The arbitrator awarded Mr. Rossetto \$364,661.33 in satisfaction of his unpaid bonuses for 2007 and 2008.

[11] Mady appealed the arbitrator’s decision that Mr. Rossetto was entitled to his bonuses.

(3) The appeal judge’s decision

[12] The appeal judge held that the arbitrator erred in law by failing to apply the principles that inform the remedies for breach of fiduciary duty in determining Mr. Rossetto’s entitlement to his bonuses despite having found that Mr. Rossetto stood in a fiduciary relationship with Mady. Relying on *McBride Metal Fabricating Corp. v. H.W. Sales Company Inc.* (2002), 59 O.R. (3d) 97 (C.A.), at paras. 26-29, and *Canadian Aero Service Ltd. v. O’Malley*, [1974] S.C.R. 592, she held that “[t]he overriding principle is that a fiduciary is not entitled to compensation for the period of their wrongdoing”: at para. 16.

[13] The appeal judge stated that “[T]he court seeks to put the aggrieved party in the position it would have been if the breach had not occurred”: at para. 16. And relying on *McBride*, she held that the only way to return Mady to its original position was to deprive Mr. Rossetto of his bonus from the date of the breach onward on the basis that “had Mady been aware that Rossetto was secretly diverting the company’s assets and resources from September 3, 2007, Mady would most assuredly have terminated Rossetto’s employment contract as it did immediately upon discovering Rossetto’s dishonest activities”: at para. 17.

[14] She was of the view that a bonus was tantamount to “property or [a] business advantage belonging to the company”. Therefore in accordance with *Canadian Aero Service Ltd. v. O’Malley*, Mr. Rossetto was disentitled to his bonuses. In her view, “the principles enunciated in *O’Malley* and *McBride* make it clear that bonuses are included in the forms of compensation a wrongdoing fiduciary is not entitled to be paid during the period of their wrongdoing”: at para. 19.

II. ANALYSIS

ISSUE 1: Did the appeal judge err in holding that there is an overriding principle which disentitles a fiduciary employee to any bonus in respect of a period of time in which he acted in breach of his fiduciary duty?

[15] The appeal judge’s conclusion that Mr. Rossetto’s breach disentitled him from receiving his bonuses was based on the erroneous principle that, in all circumstances, errant fiduciaries forfeit entitlement to compensation in the form of bonuses. Equitable

remedies are always subject to the discretion of the court, and a fiduciary's entitlement to a bonus depends on all of the facts before the court. Respectfully, the appeal judge did not consider all of those facts.

(1) The parties' positions

[16] Mr. Rossetto argues that where, as here, damages arising from the misconduct have been awarded, and the agreement to award a bonus was not induced by a misrepresentation, *McBride*, *Canadian Aero Service*, and the other cases relied on by Mady, do not require that a fiduciary be denied a performance bonus that is an integral part of the employment contract. The arbitrator did not err in principle in making his discretionary order.

[17] Mady submits that the arbitrator erred in law in failing to consider the impact of Mr. Rossetto's breach of his fiduciary obligations on his entitlement to receive his bonuses. In addition to *McBride* and *Canadian Aero Service*, Mady relies on *Procon Mining and Tunnelling Ltd. v. McNeil*, 2010 BCSC 487, 81 C.C.E.L. (3d) 119; *Clark v. Coopers; Hodgkinson v. Simms*, [1994] 3 S.C.R. 377; and *Lavigne v. Robern* (1984), 51 O.R. (2d) 60 (C.A.) as authority for the principle that a fiduciary employee is not entitled to his bonus where he has breached that duty.

(2) General principles governing fiduciary relief

[18] Fiduciary relief is equitable in nature. The remedies for breach of fiduciary duty are discretionary. They are “dependent on all the facts before the court, and designed to address not only fairness between the parties, but also the public concern about the maintenance of the integrity of fiduciary relationships”: *McBride*, at para. 30.

[19] Fiduciary relief is aimed at two goals: restitution and deterrence. Restitution is aimed at returning a beneficiary to the position he would have been in but for the fiduciary’s breach. The goal of deterrence, or as it is sometimes referred to, the prophylactic purpose, is to prevent fiduciaries from benefitting from their wrongdoing and maintain the integrity of the fiduciary relationship. A remedy for breach of fiduciary duty can be aimed at one or both of these purposes. The role each one plays is a function of the particular facts of the case: see for example *Hodgkinson v. Simms*; 3464920 *Canada Inc. v. Strothers*, 2007 SCC 24, [2007] 2 S.C.R. 177.

[20] Deterrence is of particular importance where the beneficiary suffers no identifiable loss. Such was the case in 3464920 *Canada Inc. v. Strothers*. In *Strothers*, disgorgement of profits gained through a breach of fiduciary duty was ordered not for the purpose of making the beneficiary whole; but rather, to ensure that the fiduciary did not benefit from his wrongdoing, thereby deterring fiduciary faithlessness, and achieving the prophylactic goal.

(3) The jurisprudence does not establish an overriding principle barring compensation for errant fiduciaries during the period of wrongdoing

[21] The effect of the appeal judge’s reasoning, and consequently her error, was to elevate the fact-specific result in *McBride* to an absolute principle disentitling faithless fiduciaries to compensation in the form of bonuses for the period of their wrongdoing.

[22] The cases on which the appeal judge and Mady relied do not establish that a fiduciary employee must, in all circumstances, be denied compensation in respect of the period of his wrongdoing. Rather than establishing an absolute rule, the jurisprudence affirms the well-accepted principle that equitable relief is discretionary and fact specific. The question of entitlement to bonus compensation is therefore fluid and must be determined by reference to the circumstances of the particular case, having regard to the general principles governing fiduciary relief.

[23] The appeal judge relied on the passage from *Canadian Aero Service*, at p. 10, that a fiduciary is precluded from obtaining for himself, “any property or business advantage belonging to the company.” She held that there was “no exception for a bonus”, treating the bonus as the company’s property. Respectfully, this analysis is flawed. The property that Mr. Rossetto misappropriated was that which he used to renovate his house; damages were awarded to compensate Mady for the value of that property.

[24] The appeal judge also placed significant reliance on this court’s decision in *McBride*. She treated the case as establishing a rule precluding wayward fiduciaries from

receiving compensation for the period of a breach and relied on it to find that Mady did not have to pay Mr. Rossetto's bonuses. However, a review of the decision establishes that the result is fact-specific and, importantly, that the facts of *McBride* are distinct from those in this case.

[25] In *McBride*, a sales agent did not disclose to its principal that it had a 25 per cent interest in a customer. The principal discovered this conflict of interest in 1996, two years after it arose, and terminated the agency agreement. Under the agreement, the agent was entitled to commissions for two years after termination on sales attributable to customers in existence at the time of termination. *McBride* did not request that commissions earned in the two years after the breach be returned. It did, however, seek to be relieved of the obligation to pay the "trailing" commissions in respect of the period following termination.

[26] The trial judge found that the failure to disclose the conflict of interest was a clear breach of fiduciary duty and that, had disclosure been made, the principal would have terminated the contract two years prior, with the result that commissions would only have been payable until 1996. The trial judge granted the requested declaration, relieving *McBride* of the obligation to pay the trailing commissions.

[27] The decision was upheld on appeal. Abella J.A. described the relief granted by the trial judge as consistent with the goal of putting the plaintiff in the position it would have been in but for the breach. In response to the sales agent's argument that it would be

unfair to relieve McBride from the obligation to pay the trailing commissions because it had had the benefit of the profits earned on the sales, she noted that the law of fiduciary duty has always contained within it an element of deterrence. She described the trial judge as having “exercised his *discretion* to simply “call it even” between the parties, as he was fully entitled to do”: at para. 32 (emphasis added).

[28] Unlike *McBride*, where the only “loss” to the beneficiary was its right to terminate the contract at the time of the breach, in the case before the court, Mr. Rossetto’s breach was the misappropriation and diversion of resources, resulting in an identifiable loss to Mady. Clear economic harm was made out and damages were awarded to put Mady in the position it would have been in but for the breach. Damages were not awarded in *McBride*.

[29] In further contrast, the breach in *McBride* was a conflict of interest, which was ongoing at the time McBride terminated its relationship with the fiduciary. The underlying breach in the present case - the diversion of labour, material and funds - occurred over three months in 2007. The bonuses at issue were any portion of the bonus for the whole of 2007 that remained unpaid and the bonus for the whole of 2008.

[30] The fact that the relationship at issue in the present case is one of employer and employee also distinguishes it from *McBride*, where Abella J.A. expressly recognized that the relationship at issue was one of principal and agent: at para. 26. Citing this court’s decision in *William R. Barnes Co. v. Mackenzie* (1974), 2 O.R. (2d) 659, Mark

Ellis in *Fiduciary Duties in Canada*, loose-leaf (consulted on December 16, 2011) (Toronto: Carswell, 1993), ch. 16 at 16.15 recognizes the distinction between principal-agent and employer-employee relationships and describes the entitlement to compensation in the employment context. He writes:

It is well accepted that a principal will not be required to pay his agent a commission for transactions that are in breach of fiduciary duty. However, an employer is not free to withhold payment of wages due for past performance, even where the past performance may have involved a time when the employee was acting in breach of his fiduciary duty.

[31] In *Barnes*, Evans J.A. adopted the same approach to a fiduciary employee as the arbitrator in this case. He wrote:

In the instant case the relationship is basically that of master and servant rather than principal and agent and the remedy of a master against his defaulting servant is restricted to a right of instant dismissal and to damages which flow from the default. I do not consider wages paid to be such an item of damages. ... The employer has already received the fruit of the employer's efforts, honest or otherwise, and cannot repudiate his obligation to pay. I recognize that in an agency situation the principal may take the benefit and refuse to pay the commission but I am not aware of any binding authority which requires me to extend that principle to a master and servant situation.

[32] Recognizing that *Barnes* predates *McBride*, there is nothing in *McBride* that contradicts the above proposition, particularly given that *McBride* involved an agency relationship. Nor is there anything in *McBride* that suggests the result reaches any further than the facts of that case. The same is true of the other cases put forward by Mady.

[33] *Procon Mining*, a decision of the British Columbia Supreme Court relied upon by Mady on this appeal, is the only decision cited where a fiduciary employee was not entitled to his bonus. Notably, only one of two employees was denied a bonus. The case reflects a fact-specific exercise of discretion in crafting fiduciary relief.

[34] In *Procon Mining*, the court required the defendant to pay back bonus and other monies paid out by the employer in accordance with an extremely favourable option agreement the defendant had negotiated while secretly accepting commissions from Procon's suppliers and clients. The court held that allowing him to retain the bonuses (and other monies) would be to allow him to profit from his non-disclosure because it was only through that non-disclosure that he was able to negotiate key provisions of the option agreement.

[35] The court specifically noted that the bonuses paid to McNeil, which were analogous to distributions to shareholders, were not "traditional performance bonuses". Notably, the court allowed McNeil's assistant, (whom it had also held breached a fiduciary duty through assisting him in his breaches), to keep her "traditional performance bonus".

[36] In this case, the arbitrator found that the bonuses at issue were an integral part of Mr. Rossetto's employment contract. They were what the trial judge in *Procon Mining* described as "traditional performance bonuses". And unlike *Procon Mining*, where the

fiduciary had resigned and immediate termination of his employment was not available to deter fiduciary faithlessness, Mr. Rossetto was dismissed as a consequence of his breach.

[37] *Clark v. Coopers*, relied upon by Mady and distinguished by the arbitrator, stands for the narrow proposition that an employee who is dismissed for fraudulently misrepresenting his qualifications to gain employment, is not entitled to remuneration because the employment contract is *void ab initio*. This is not a case of fraudulent misrepresentation of an employee's credentials.

[38] *Lavigne v. Robern*, a case where a shareholder was denied his proportionate share of a secret commission that he was forced to disgorge to the corporation, is likewise of no assistance. It does not consider fiduciary relief in an employment context. Moreover, some ten years after *Lavigne v. Robern*, this court came to the opposite conclusion in *Olson v. Gullo* (1994), 17 O.R. (3d) 790.

[39] In *Olson*, Messrs. Olsen and Gullo agreed they would be equal partners in the purchase and development of certain lands. Gullo bought and sold some of that land behind Olsen's back. Gullo was required to pay one half of the profits (and not the 100 per cent ordered by the trial judge) to Olson. Morden A.C.J.O. held that allowing the wrongdoing partner his pre-ordained share did not amount to allowing him to profit from his wrongdoing.

ISSUE 2: Should the arbitrator's award granting Mr. Rossetto the bonuses earned as part of his employment be reinstated?

[40] Given that an errant fiduciary is not strictly barred from receiving compensation in the form of bonuses as a consequence of wrongdoing, the question becomes whether the arbitrator's award should be reinstated. While a wayward fiduciary may in certain cases be denied bonus compensation to achieve the goal of restitution or deterrence, I am of the view that the arbitrator's conclusion in this case was reasonable and would reinstate the award.

[41] The heart of Mady's complaint is that the arbitrator failed to explicitly consider whether treating Mr. Rossetto as a fiduciary, and not simply an employee, would provide a more appropriate remedy to Mady. It argued that, as a fiduciary, Mr. Rossetto was not entitled, or at least not necessarily entitled, to his bonuses.

[42] Despite the fact that Mady's arbitration claim in relation to the bonuses was framed as flowing from Mr. Rossetto's termination for cause, I agree that the arbitrator erred in not explicitly considering whether treating Mr. Rossetto as a fiduciary would provide a more appropriate remedy to Mady: see *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 S.C.R. 574, at pp. 631-632.

[43] Nonetheless, while the arbitrator did not expressly conclude that Mr. Rossetto was in a fiduciary relationship with Mady, it is clear from his findings of fact that the arbitrator – a former law school dean – appreciated that Mr. Rossetto was a fiduciary.

Moreover, the approach of the arbitrator in determining bonus entitlement was consistent with *Barnes*, a case involving a fiduciary employee, and as discussed below, his award was reasonable, having regard to all of the facts and the general principles governing fiduciary relief.

[44] There are different kinds of bonuses. Some are discretionary. Some are simply a form of variable, as opposed to fixed, compensation. Sometimes, a bonus amounts to the principal form of compensation. In this case, the bonuses were significant and non-discretionary. The arbitrator found they were an integral part of Mr. Rossetto's compensation under the employment contract. He was just as entitled to the bonus component of his compensation as he was to his regular salary.

[45] Furthermore, the arbitrator's award accomplished the goals of fiduciary relief. Mady suffered a tangible loss as a result of Mr. Rossetto's breach of fiduciary duty. That loss could be, and indeed was, compensated by the arbitrator's award for damages, an award that was crafted on evidence of loss that was "far from clear". By requiring Mr. Rossetto to compensate Mady for the time, money and resources he misappropriated, as well as the delay occasioned by his conduct, Mady was put back in the same position it would have been in but for the breach; the goal of restitution on which the appeal judge focussed was fully achieved.

[46] The arbitrator's award also accounted for prophylactic goal of fiduciary relief. It had the effect of depriving Mr. Rossetto of the benefit he gained from his wrongful conduct.

[47] This was not a case where Mr. Rossetto was left unimpaired by his wrongdoing. Mr. Rossetto lost his job. He was dismissed as soon as Mady became aware of his misconduct.

III. CONCLUSION

[48] The arbitrator carefully considered the nature of the bonuses, and the attitude of this court to bonus payments that form an integral part of an employee's compensation. He heard all of the evidence and calculated the damages arising from Mr. Rossetto's misconduct. His reasons show that he was alive to the fiduciary relationship but concluded that it was nonetheless *appropriate on the facts of the case* to treat Mr. Rossetto as an employee. The conclusion he reached was reasonable and remains reasonable when viewed in the light of the fiduciary relationship. I would not interfere.

[49] In the result, I would restore the award of the arbitrator.

[50] As agreed to by the parties at the hearing, Mr. Rossetto is entitled to costs of this appeal on a partial indemnity scale, fixed in the amount of \$15,000, inclusive of disbursements and applicable taxes, and the costs of the appeal below, which were awarded to Mady and fixed by the arbitrator, are set aside. Mr. Rossetto shall be entitled

to his costs of the appeal below, which are fixed in the amount of \$17,000, inclusive of disbursements and applicable taxes.

RELEASED: Jan. 17, 2012
“D.D.”

“Alexandra Hoy J.A.”
“I agree Doherty J.A.”
“I agree Armstrong J.A.”