
CANADA / JUDGMENT

Walek v. Guardian Storage Inc.

2010 BCSC 365

COURT

Supreme Court of British Columbia

DECIDED

19 March 2010

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2010 BCSC 365 Walek v. Guardian Storage Inc.

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

Walek v. Guardian Storage Inc.,

2010 BCSC 365

Date: 20100319

Docket: S056199

Registry: Vancouver

Between:

Marek Walek

Plaintiff

And

Guardian Storage Inc., Angela Mainardi

and Greg Samek

Defendants

Corrected Judgment: The text of this judgment was
corrected at paragraph 70 on April 1, 2011.

Before: The Honourable Madam Justice Fenlon

Reasons for Judgment

Counsel for the Plaintiff:

D. J. Taylor

Counsel for the Defendant:

M. T. L. Blaxland

Place and Date of Trial:

Further Argument:

Vancouver, B.C.

June 22-26, July 29-31, 2009

January 26, 2010

Place and Date of Judgment:

Vancouver, B.C.

March 19, 2010

INTRODUCTION

[1] The plaintiff Marek Walek, and the defendant Angela Mainardi, joined forces through the defendant Guardian Storage Inc. ("Guardian") to develop a mini storage facility in Vancouver. They did not put this arrangement in writing. The plaintiff now sues in breach of contract and for oppression under the Business Corporations Act, S.B.C. 2002, c. 57. The defendants deny the contract on the terms alleged. In the alternative, the defendants argue that the contract should not be enforced by the court because it was entered into with the intent to avoid the plaintiff's obligations to his creditors in bankruptcy.

ISSUES

[2] There are five main issues to be addressed:

1. What are the terms of the parties' agreement?
2. Has the prerequisite repayment to Ms. Mainardi been made?
3. Should an adverse inference be drawn against the defendants?
4. Should the Court refuse to enforce the agreement on public policy grounds?
5. Is the agreement a nullity?

ANALYSIS

1. What are the terms of the parties' agreement?

- [3] Ms. Mainardi submits that the plaintiff has failed to prove that the parties reached an agreement on the terms asserted. Because the agreement was not put in writing, the case turns largely on whether I accept Ms. Mainardi's or Mr. Walek's testimony. I begin by reviewing the undisputed sequence of events that preceded the alleged agreement.
- [4] In the summer of 2003, Mr. Walek's business acquaintance, Dave Suprunec, discovered an opportunity to start a mini storage business: the owner of a storage facility was willing to give Suprunec more than 500 storage lockers if he would remove them. Mr. Suprunec and Mr. Walek decided to incorporate a company, reconstruct the storage units in a new location, and then sell the venture as a turnkey operation. Mr. Suprunec was to hold 40% of the shares and Mr. Walek 60%. Mr. Suprunec would "earn" his shares by overseeing the removal and the reconstruction work; Mr. Walek would be responsible for financing the project. Mr. Walek brought his business partners in an unrelated company, Samek Fabrication and Marine Welding Ltd., into the venture to help finance it; George Lessani and Greg Samek were each allocated 20% of Mr. Walek's 60% shareholding. The defendant Guardian was incorporated on September 29, 2003, on that basis. (Greg Samek was originally named as a defendant in these proceedings but the plaintiff discontinued the action against him at the outset of trial.)
- [5] On October 1, 2003, Mr. Walek leased premises on West 7th Avenue in Vancouver on behalf of Guardian, although officially the tenant was Samek Fabrication and Marine Welding Ltd. because the landlord wanted an established company on the lease.
- [6] George Lessani quickly lost interest in the project and by October 3, 2003, had transferred his shares back to Mr. Walek. Greg Samek did so as well, leaving Mr. Walek with his original 60%. Eventually Mr. Samek's interest in the venture revived; he made the deposit and first payment on the lease for \$31,425. While initially some of the labour costs to remove the lockers were paid by Samek Fabrication and Marine Welding Ltd., Mr. Walek also paid labour and other expenses related to the transport and storage of the lockers and subsequent reinstallation at the new site.
- [7] By late 2003, Mr. Walek realized that he could not finance the construction on his own. Mr. Samek introduced Mr. Walek to Angela Mainardi. Ms. Mainardi agreed to invest the money needed to complete construction of the lockers. At this point in the story the parties' versions of events diverge.
- (a) The defendants' version of the agreement
- [8] Ms. Mainardi says Mr. Samek and Mr. Walek agreed to give her their entire 60% interest in the company if she would finance the remaining construction costs. She says that the plan from the outset was that they would operate the storage locker company; as profits came in, she would be repaid all of the money she had invested, after which the plaintiff and Mr. Samek would be repaid their construction loans. Ms. Mainardi says this agreement was reached on January 27, 2004, when they attended the office of a notary public she knew and signed documents transferring 60 shares in Guardian from the plaintiff to her. Ms. Mainardi

gave evidence that the agreement was amended in May 2004 after she decided to buy Dave Suprunec's 40% shareholding. Cash was tight and she needed help. She says Mr. Walek and Mr. Samek agreed to work part-time for the company without immediate compensation in exchange for payment on a quantum meruit basis once all the loans had been repaid and profits permitted.

(b) The plaintiff's version of the agreement

- [9] Mr. Walek agrees that in December 2003, Ms. Mainardi committed to loan money to Guardian to cover completion of construction. But he says that in return she was to receive 20% of the company's shares as temporary security for that loan; he and Mr. Samek were each left with 20% of the shares and Dave Suprunec with 40%. The business was to be sold as a turnkey operation and from the proceeds of the sale Ms. Mainardi was to be repaid her construction loan before the other investors were reimbursed.
- [10] Mr. Walek says this agreement was amended twice. The first amendment occurred in early January 2004 when Mr. Walek became concerned that guarantees he had provided to secure debts owed by the financially troubled Samek Fabrication and Marine Welding Ltd. might put him into bankruptcy, resulting in creditors attaching his 20 shares in Guardian. He says Ms. Mainardi agreed to hold Mr. Samek's and Mr. Walek's 20 shares in trust for each of them, and to return their shares on demand.
- [11] Mr. Walek says the second amendments to the agreement occurred in May 2004 when the construction of the locker facility was nearing completion. At that point Dave Suprunec, who had overseen the reconstruction work, wanted to sell his 40% stake in Guardian and Angela Mainardi agreed to purchase his shares for \$110,000. Mr. Walek says that at a meeting in May, he, Mainardi and Samek agreed to four changes to their agreement. First, they decided to operate Guardian rather than selling it. Second, Ms. Mainardi was to make an operating loan to the company in addition to the construction loan she had already made. Third, in keeping with the terms of the original agreement, Ms. Mainardi was to be repaid both the construction and operating loans from Guardian's profits in priority to Mr. Samek and Mr. Walek being repaid for their cash contributions to the company, and once she was repaid, she was to give up the 20 shares she had received as security for her investment: 10% to Walek and 10% to Samek. Fourth, Mr. Walek and Mr. Samek agreed to work as part-time managers for Guardian to keep costs down and to defer payment for their work until profits permitted. As managers, they were to have access to the financial records of the company.

(c) Has the plaintiff proved the agreement on the terms alleged?

- [12] I find that the plaintiff has proved the agreement on the terms pleaded. My reasons for that finding follow.

(i) Letter written by the defendant Mainardi in June 2004

- [13] On June 12, 2004, Ms. Mainardi wrote a letter to Mr. Walek and Mr. Samek. That letter is a significant document because it is the only attempt the parties made to put their agreement in writing. The letter was written just as construction finished and Guardian opened its doors to customers, some six months after Ms. Mainardi first decided to invest in the company. In addition, just four days before the letter was written, Mr. Samek and Mr. Walek had made personal assignments into bankruptcy.
- [14] As Guardian began operating, Mr. Walek and Mr. Samek were growing concerned because they had nothing in writing documenting their agreement with Ms. Mainardi. A meeting took place at Ms. Mainardi's home with Lucyna Walek, the plaintiff's wife (now former wife) and Greg Samek's wife, Iwona Samek. At that meeting, Mr. Samek and Mr. Walek asked Ms. Mainardi to set out the terms of their agreement in writing. Shortly after the meeting, Ms. Mainardi wrote to Mr. Samek and Mr. Walek:

To all parties concerned in reference to Guardian Storage, located at 151 West 7th Ave Vancouver. Prior to any profits by the company all original investments must be re-paid and only then will the share holders begin to gain profit share from Guardian Storage. All shares have been transferred into the name of Angela Mainardi. At this time Ms. Mainardi is the only signing authority on the company and will remain in this position for one additional year. At witch [sic] time a review will take place and the other shares [sic] holders will determine, if they wish to have the (20% each) of the shares transferred back into their names. If at that time they chose to transfer Ms. Mainardi has agreed to their future request. If at the time of review they chose not to transfer a six-month hold will be put into place and reviewed at the later date of request. This verbal and signed agreement between - Angela Mainardi

Iwona Samek

Lucyna Walek

Shall be reviewed in 12/June/2005 (first request) and if a second review is required it will take place 12/December/2005.

Signed, 12/June/2004

Angela Mainardi "Angela Mainardi"

Iwona Samek "Iwona Samek"

Lucyna Walek

- [15] It was Ms. Mainardi's evidence that Mr. Walek and Mr. Samek had transferred all of their shares to her absolutely in January 2004 so that she held the 60 shares that had been issued to Mr. Walek originally as well as the remaining 40 shares she had acquired from Dave Suprunec, leaving her with 100% of the company. In my view, that evidence is inconsistent with the agreement she confirmed in her letter of June 12, 2004. The reference to "shareholders" is at odds with Ms. Mainardi's evidence that she was the only shareholder in

the company. Further, the reference to other shareholders determining, "if they wish to have their (20% each) of the shares transferred back into their names", is inconsistent with Ms. Mainardi's denial that she held the plaintiff's 20 shares in trust and was to return them to him on demand.

- [16] In cross-examination Ms. Mainardi explained the letter by saying that the "other shareholders" were Iowna Samek and Lucyna Walek. When pressed as to how shares could be transferred back to them when they had never been shareholders, Ms. Mainardi said cryptically, "it was the suggestion of the men that if there was any profit in Guardian they wanted it to go to their wives."
- [17] In her direct evidence, Ms. Mainardi stated that Mr. Samek first told her in May or June of 2004 that Samek Fabrication was not doing well and that he and Mr. Walek were going to have to declare personal bankruptcy. Ms. Mainardi testified that they "wanted their shares to be transferred to their wives". When asked by her counsel what she meant by "their shares" Ms. Mainardi replied that Mr. Samek and Mr. Walek "wanted some sort of future interest in Guardian". She also said she wrote the letter because she thought that Guardian could end up in the bankruptcy proceedings that Mr. Samek and Mr. Walek had initiated. In cross-examination when asked how that could be when they owned no interest in Guardian, she said "I don't know how to answer that." When pressed to acknowledge that it was their trust interest in the shares that she did not want to go into the bankruptcy proceedings, Ms. Mainardi originally said there was "no trust agreement drafted up," but in the end agreed "yes, they had an interest in the business in June 2004 and always had such an interest." In re-examination by her counsel she tried to back away from that admission by stating that when she used the words "interest in the business," she meant only that they had showed interest in the business because they had introduced her to the storage locker company and "had offered to help."
- [18] In the context in which the questions were asked, I do not accept that explanation. I find that Ms. Mainardi prepared the June 12, 2004 letter to make it appear that the 20% interest she held in trust for each of Mr. Samek and Mr. Walek was held for their wives in order to shield that interest from the bankruptcy proceedings.

(ii) Reliability of the parties' testimony

- [19] I found Mr. Walek's evidence to be consistent, detailed and supported by the evidence of the other witnesses at trial. In contrast, Ms. Mainardi's evidence throughout the trial was fragmented, inconsistent and often incomprehensible. She repeatedly answered questions in cross-examination by saying she could not remember or could not be sure. Ms. Mainardi acknowledged that her memory of events was poor and, when pressed on cross-examination, acknowledged that the agreements the plaintiff and Mr. Samek attested to could have occurred; she simply "could not remember them".

- [20] Further, Ms. Mainardi repeatedly changed her testimony from that given on examination for discovery. For example, at trial she denied knowing that Mr. Walek had spent his own money to construct the locker facility before she became involved. But on discovery conducted less than a month before trial, Ms. Mainardi admitted Mr. Walek had told her that he had put money into the company and that she believed him. Accordingly, where the evidence of the parties conflicts, I prefer the evidence of Mr. Walek.
- [21] Ms. Mainardi submits that it is improbable that she made the agreement claimed by the plaintiff. She says that if she holds 20 shares in trust for Mr. Samek and the plaintiff and is obligated to transfer a further 10% to each of them once her loans are repaid, she would be left with only the 40 shares she purchased from Mr. Suprunec for \$110,000. In effect, says Ms. Mainardi, on the plaintiff's version of the agreement, she will have covered the significant operating and construction costs of Guardian for many years without acquiring any interest in the company for her investment and time.
- [22] I agree with Ms. Mainardi that, as things turned out, this was not an advantageous bargain for her. But in May 2004, when the deal was made, the business was not yet up and running. The parties had every expectation that the venture would be a profitable one, and that Ms. Mainardi's investment would be repaid in short order. Instead, the company struggled financially and Ms. Mainardi had to cash in her RRSPs to make ends meet. Ms. Mainardi made the agreement on the terms alleged by the plaintiff, however, and must live with that bargain, good or bad.
- [23] In summary on this issue, I find that the plaintiff has proved the agreement on the terms set out in paras. 10 and 11 of these reasons. It follows that Ms. Mainardi holds 20% of Guardian's shares in trust for the plaintiff, returnable on demand. Mr. Walek is therefore entitled to the immediate transfer of those shares.
- [24] Ms. Mainardi is also required to transfer a further 10% of her shares to Mr. Walek after Ms. Mainardi's loans have been repaid and profits permit to repay Mr. Walek's construction loan and to compensate him for his part-time management work on a quantum meruit basis. There are a number of issues that must be determined in relation to these latter terms of the agreement. First, what is the amount of Mr. Walek's shareholder's loan to the company? Second, how many hours did he work as a part-time manager? Third, what is the appropriate compensation for that work? Each of these issues is addressed below.
- (d) What is the amount of Mr. Walek's construction loan to Guardian?
- [25] Mr. Walek claims he loaned \$35,000 to Guardian to cover the cost of removing, transporting, storing and partially reconstructing the lockers. The defendants argue that Mr. Walek has not proved that he is owed this or any other sum.
- [26] The defendants are correct that there is little documentary evidence to support Mr. Walek's claim. He explains this by saying that he loaned the money largely by way of cash payments for labour. Although Mr. Walek did not put into evidence any bank records showing cash

withdrawals, Lucyna Walek testified that she was aware that Mr. Walek was putting cash into the company. Dave Suprunec, who oversaw the removal and reconstruction of the lockers, confirmed Mr. Walek gave him \$10,000 - \$12,000 in cash to cover the cost of removing the lockers, which sum did not include the cost of the truck and shipping. Mr. Suprunec moved 50 - 60 skids of structural steel and said that there were significant expenses incurred in the removal.

[27] Mr. Suprunec testified that the work on Guardian's premises began in October 2003. He said there was a labour shortage in the construction industry at that time and workers wanted to be paid in cash at the end of each week. He confirmed that Mr. Walek provided cash every week to cover the wages. Mr. Suprunec could not recall the exact amount but said it would be at least \$30,000. He said he kept detailed records and receipts of all of the expenses to complete the construction "from Day 1 when [Walek] started to pay me to the end of the project". He gave all of those records to Angela Mainardi. Mr. Suprunec said construction of the new facility was 20% complete when Angela Mainardi began making payments and he agreed she paid about \$75,000 between January 31 and May 4, when the work was almost complete and he left the project. Ms. Mainardi did not dispute receiving records of Mr. Walek's contributions. She gave evidence that many documents were "lost in a flood" which occurred at the travel agency she operates.

[28] Mr. Suprunec and Ms. Walek were disinterested, reliable witnesses. I find it probable that Mr. Walek paid construction costs of about \$18,000 to install the lockers at the new facility, \$10,000 - \$12,000 for removal of the lockers and an additional sum to transport them, bringing his loan to Guardian to the \$35,000 claimed. In accordance with the terms of the agreement, Mr. Walek is entitled to repayment of that sum from Guardian after Angela Mainardi's loans to Guardian have been satisfied.

(e) How many hours did Mr. Walek work as a part-time manager?

[29] As noted above, under the agreement, Guardian is required to compensate the plaintiff for the hours he worked for the company between May 2004 and September 2005 on a quantum meruit basis, i.e., based on the market value of that work: G.H.L. Fridman, Quantum Meruit (1999) 37 Alta. L. Rev. 38; Sutherland v. D.A. Townley and Associates, [1998] B.C.J. No. 1116 at paras. 33-34 (S.C.). The plaintiff claims \$15,000 for this work; the defendant says \$3,500 - \$4,500 is adequate compensation. The first step in addressing what is due to Mr. Walek is a determination of the number of hours he worked.

[30] I find that the plaintiff worked 9:00 - 5:00 on Saturdays and 11:00 to 4:00 on Sundays on alternate weekends for a total of approximately 26 hours per month during that period.

(f) What hourly rate should be used?

[31] Mr. Walek acted as a part-time manager. He hired and dismissed employees, entered into contracts on behalf of Guardian, and arranged advertising. The bookkeeper reported financial results to Mr. Walek.

[32] Ms. Mainardi acknowledges that she currently pays her boyfriend \$12 per hour to do work for the company which involves less management work than the work done by the plaintiff. Mr. Latkiewicz was also paid \$12 per hour for bookkeeping and secretarial work. In my view the plaintiff has established that compensation at the slightly higher level of \$15/hour is fair market value. Therefore, assuming 26 hours of work per month for 16 months (from the end of May 2004 to September 2005), the plaintiff is owed \$6,240 by Guardian for his services, which sum is payable once Ms. Mainardi's construction loans have been repaid by the company and Guardian's profits permit.

[33] As noted earlier, the defendants' obligations under the agreement, other than Ms. Mainardi's obligation to transfer the 20 shares she holds in trust for Mr. Walek, are contingent both on Guardian's repayment to Ms. Mainardi of her construction and operating loans, and on Guardian earning sufficient profits to pay Mr. Walek the sums due to him. The next issue to be addressed is, therefore, whether the prerequisite repayment to Ms. Mainardi has been made.

2. Has the prerequisite repayment to Ms. Mainardi been made?

[34] Because of Guardian's failure to create and retain financial records, (a finding that will be addressed later in these reasons) there is insufficient evidence before the court to determine with any precision the status of Ms. Mainardi's loans to the company. The plaintiff therefore sought the appointment of an inspector under s. 248(3) of the Business Corporations Act, to audit the company and determine what, if anything, remains owing to Ms. Mainardi.

[35] There are two issues to be addressed in relation to this submission: first, is this remedy available to the plaintiff? Second, should the court exercise its discretion to appoint an inspector?

(a) Is the remedy of an inspector available to the plaintiff?

[36] Section 248 of the Business Corporations Act provides that:

248 (1) Subject to subsection (3), on the application of one or more shareholders who, in the aggregate, hold at least 1/5 of the issued shares of a company, the court may

(a) appoint an inspector to conduct an investigation of the company, and

(b) determine the manner and extent of the investigation.

...

(3) The court may make an order under this section if it appears to the court that there are reasonable grounds for believing that

(a) the affairs of the company are being or have been conducted, or the powers of the directors are being or have been exercised, in a manner that is oppressive or unfairly prejudicial to one or more shareholders, within the meaning of section 227 (1), including the applicant,

- [37] At all material times, Mr. Walek has held a beneficial interest in 20% of the shares of the company. He asserts that the affairs of the company have been conducted in a manner that is oppressive to him. I agree with that assessment.
- [38] It was a term of the agreement that the plaintiff was to hold the position of part-time manager and was to have access to Guardian's financial records, but the defendant terminated Mr. Walek's position in September 2005 and thereafter refused to provide him with any information about the company's financial affairs.
- [39] Ms. Mainardi explained her decision to terminate Mr. Walek's employment on the basis that she asked him to loan more money to the company to cover expenses and "he did not respond" to her request. But Mr. Walek was not obliged to loan further funds to Guardian. Under the agreement, he was to provide a significant part of the management of the company on a deferred compensation basis. The evidence established that Ms. Mainardi, who continued to work full-time at her travel agency business, was only infrequently in the Guardian office. There was no evidence to suggest that Mr. Walek failed to perform the services he contracted to perform. Ms. Mainardi's termination of the plaintiff's involvement in the company, and her refusal to provide him with information about the company's finances was oppressive, particularly because payment for his work and repayment of his construction loan depended on the financial performance of the company. Without that information, he had no way of knowing whether he was entitled to repayment. In addition, I note that, quite apart from the express term of the agreement entitling Mr. Walek to access to financial information about the company, Mr. Walek, as a beneficial shareholder, should have been provided with that information: Business Corporations Act, s. 196(4).
- [40] Further, Ms. Mainardi by her own admission failed to record cash sales, failed to report all of Guardian's earnings on corporate tax returns, and has not kept records as required under s. 196 of the Business Corporations Act.
- [41] In summary on this point, I am of the view that Ms. Mainardi's termination of Mr. Walek's management role with the company without cause, her failure to maintain adequate records, her refusal to provide Mr. Walek with information about the company's finances, and her refusal to return his 20% shareholding to him, constitute oppression as that term is used in s. 248 of the Business Corporations Act.
- [42] I am also satisfied that the plaintiff has exhausted all other remedies available to him through discovery and pre-trial orders to obtain financial information from Guardian: *Rosemont Enterprises Ltd. v. Mercury Industrial et al*, 2005 BCSC 1339, 9 B.L.R. (4th) 285 at para. 64.
- [43] The plaintiff has therefore met the conditions precedent to appointment of an accountant to inspect and audit the defendant Guardian's financial records under s. 248 of the Business Corporations Act.
- (b) Should the court exercise its discretion to appoint a receiver?

[44] In exercising my discretion under s. 248(1) of the Business Corporations Act, I must consider whether appointment of an inspector is an appropriate remedy in the most basic sense, i.e., is it likely to remedy the situation complained of? In my view it will not, because an accountant cannot inspect and audit documents that both parties acknowledge do not exist. The case at bar is, therefore, unlike the case of *Fedel v. Tan* (2008), 93 O.R. (3d) 274, 60 B.L.R. (4th) 117 (S.C.J.) (paras. 13-21, 22 and 98) relied on by the plaintiff in which the Court found the defendant director had failed to produce meticulous records he had kept in his possession. In this case, if an inspector is appointed, an audit would be expensive, time consuming, ultimately futile, and would almost certainly result in further litigation. The cost of the exercise, if borne by the defendant company, would erode profits and further delay repayment of the plaintiff. It is also probable that the cost of an audit would be disproportionate to the amount in issue between the parties.

[45] Defendants' counsel submits that in these circumstances it is preferable for the court to determine the amount due to Ms. Mainardi based on the admittedly incomplete evidentiary record. Plaintiff's counsel argues, in the alternative, that based on the defendants' failure to prepare and produce financial records, the court should draw an adverse inference against the defendants and find that Ms. Mainardi's loans to the company have been repaid in full.

3. Should an adverse inference be drawn against the defendants?

[46] An adverse inference may be drawn against a party who fails to adduce material evidence without a satisfactory explanation: *Wigmore on Evidence*, 3rd ed., Vol. II, p. 162:

... The failure to bring before the tribunal some circumstance, document, or witness, when either the party himself or his opponent claims that the facts would thereby be elucidated, serves to indicate, as the most natural inference, that the party fears to do so, and this fear is some evidence that the circumstances or document or witness, if brought, would have exposed facts unfavourable to the party. These inferences, to be sure, cannot fairly be made except upon certain conditions; and they are also open to explanation by circumstances which make some other hypothesis a more natural one than the party's fear of exposure. But the propriety of such an inference in general is not doubted

... The nonproduction of evidence that would naturally have been produced by an honest and therefore fearless claimant permits the inference that its tenor is unfavourable to the party's cause ...

[47] How do the defendants explain their failure to produce financial records? Ms. Mainardi acknowledged that she was responsible for, and in control of, the financial record keeping of the company. She said electronic financial records were kept but were lost because her computer "crashed". She said she also kept paper records for Guardian but moved them from the locker facility to her travel agency, where they were lost in a flood. Despite being asked to disclose documents to prove the insurance claim she said she made in relation to that flood, she failed to do so. David Suprunec testified that he kept receipts for all of the items paid for by the plaintiff and by Ms. Mainardi. When he left the project in May 2004, he said

he gave all those documents to Ms. Mainardi. Ms. Mainardi acknowledged receiving those financial records from Mr. Suprunec, but said that they too had been lost.

- [48] Bogden Latkiewicz worked as the manager at Guardian from January 2006 until August 2007 and said he kept detailed records in a journal and on his computer of payments made by customers by credit card, cash, or cheque, setting out the amount paid, customer name, the date and the storage locker number. Mr. Latkiewicz said the records he kept "disappeared" in June of 2007. He then started a new set which also disappeared. The journal created by Mr. Latkiewicz was not disclosed by Ms. Mainardi until she became aware that counsel for the plaintiff had knowledge of its existence, despite two earlier court orders in this action compelling her to produce documents.
- [49] In assessing Ms. Mainardi's explanation for failing to produce relevant financial documents, I also take into account the following. First, Mr. Latkiewicz's evidence that Ms. Mainardi paid him for overtime in cash and paid other employees in cash including a number who were collecting unemployment insurance. Second, Ms. Mainardi withheld information about cash revenues from the accountants preparing Guardian's income tax returns in 2004, 2005, 2006, and 2007. Those tax returns were amended only when she was confronted with that wrongdoing at her examination for discovery in this action.
- [50] Third, the records that were produced show a tally of Ms. Mainardi's loans to the company without supporting documentation or receipts. For example, payments she claimed to have made to the company from her personal bank accounts were not supported by bank statements. This action was commenced in November 2005, immediately after the defendants terminated the plaintiff's management position and shut him out of the company. Ms. Mainardi acknowledged that she knew it was important to properly record the income of Guardian because her obligation to pay Mr. Samek and Mr. Walek was contingent on the financial performance of Guardian. She admitted that she knew from the time the agreement was made in January 2004, and certainly after the lawsuit was commenced in November 2005, that what she had loaned the company, what the company earned, and amounts it repaid her, were all squarely in issue. Despite this, Ms. Mainardi testified that she did nothing to request bank statements, cancelled cheques, or any other documents to support her loans to the company.
- [51] Fourth, the summary Ms. Mainardi put into evidence to support her shareholder's loans contains obvious errors such as an entry for the lease deposit of \$31,425 -- there was clear documentary evidence to show that Mr. Samek paid that sum. Ms. Mainardi also included the \$110,000 she paid Dave Suprunec to purchase his 40% shareholding, although as the trial progressed, Ms. Mainardi withdrew that claim, acknowledging that it could not be a shareholder's loan.
- [52] The defendants argue that an adverse inference should not be drawn based on the inadequacy of Guardian's records because the plaintiff failed to call expert evidence to establish that the accounting records fell below the standard to be expected of "a privately

held British Columbia company where all shares are registered to one person". The defendants also submit that it would be improper to draw an adverse inference because the plaintiff failed to subpoena the defendants' accountant "to prove that the financial records were unreliable". I do not accept these submissions. Ms. Mainardi's testimony established the lack of reliability of the financial documents produced, and expert evidence is not necessary to establish the standard of record keeping required under the Business Corporations Act. At a minimum, a company must accurately report its expenses and revenues.

- [53] Nor do I accept Ms. Mainardi's evidence that she caused Guardian to keep adequate records that were subsequently lost in a flood and a computer failure. Instead, I find that Ms. Mainardi failed to keep adequate records of the loans she made to the company, the payments she received from the company, and the company's earnings. In these circumstances, it is appropriate for the court to draw an adverse inference and to conclude that, had financial records been properly kept and produced, they would confirm that Guardian owes Ms. Mainardi less than the \$178,977 she claims remains outstanding.
- [54] Mr. Walek argues that the inference should be drawn that all of Ms. Mainardi's loans have been repaid. But in my view, to do so would work an injustice. The evidence as a whole suggests that Ms. Mainardi loaned significant sums to Guardian, which I find probably exceeded \$200,000. I also find that the company struggled financially in 2004 and for much of 2005, only earning a profit in 2006. I therefore find it unlikely that Ms. Mainardi's loans have been repaid in full. While the evidentiary record is sparse, in these circumstances, if the plaintiff is to have a remedy, I must do my best to determine the amount remaining due to Ms. Mainardi.
- [55] Ms. Mainardi insisted that to this day, Guardian "is barely making money". But cash payments were not recorded in company revenues, and these were a significant component of Guardian's earnings: Bogden Latkiewicz testified that the fragment of records he retained for 2007 showed the company received cash payments of \$1,851 in January, \$1,740 in February, and \$2,330 in March.
- [56] Mr. Walek testified that Guardian had begun to turn a slight profit in September 2005 when it had 200 lockers rented out. Mr. Latkiewicz said 265 lockers had been rented by 2007. Customers paid fees ranging from \$32 to \$132 per month, depending on the size of the locker rented. Using \$50 per month per locker, an additional 65 lockers would bring in \$3,250 per month above the "break even" costs of the company or \$39,000 per year in profit. Discounting that sum by \$1,250 per month to reflect non-payment of accounts by some customers, increased costs associated with additional customers, fluctuations in the number of lockers in use over the years, and the payment of some expenses by cash, I find it likely that Ms. Mainardi drew out on average \$24,000 per year, or \$72,000 over the last three years. Ms. Mainardi made no claim to be entitled to a salary or compensation from Guardian; accordingly, payments she received are properly characterized as repayment of her loans to Guardian.

- [57] Deducting the sum of \$72,000 from the amount Ms. Mainardi claims is due (\$179,000) and deducting the \$31,500 she says she loaned the company to pay for the lease (which I have found was paid by another investor), I estimate that Ms. Mainardi's shareholder's loan stands at about \$75,500.
4. Should the court refuse to enforce the agreement on public policy grounds?
- [58] The court may refuse to enforce a contract on grounds of "public policy", which includes illegal agreements. A distinction is drawn in the authorities between common law and statutory illegality, both of which may lead a court to refuse to enforce a contract or provide a remedy to a party who has advanced property under such an agreement: S.M. Waddams, *The Law of Contracts*, 5th ed. (Toronto: Canada Law Book, 2005) at ¶558.
- [59] The defendants say that Mr. Walek used the agreement to hide his assets from his creditors in contravention of the Bankruptcy and Insolvency Act, and should not now be permitted to enforce the agreement.
- [60] When Mr. Walek declared personal bankruptcy in June 2004, he did not disclose the construction loan of \$35,000 that he claimed Guardian owed him; nor did he declare his 20% interest in the shares of Guardian. He explained this by saying that he did not consider the in trust shares to be "realized yet", but I do not accept that explanation. Mr. Walek had declared bankruptcy previously, and had declared his shares in Samek Fabrication and Marine Welding Ltd. I find Mr. Walek transferred his shares into Ms. Mainardi's name in order to avoid losing them in the bankruptcy proceedings.
- [61] Mr. Walek's conduct contravened the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3, s. 158(d):

158 A bankrupt shall

- (d) within five days following the bankruptcy, unless the time is extended by the official receiver, prepare and submit to the trustee in quadruplicate a statement of the bankrupt's affairs in the prescribed form verified by affidavit and showing the particulars of the bankrupt's assets and liabilities, the names and addresses of the bankrupt's creditors, the securities held by them respectively, the dates when the securities were respectively given and such further or other information as may be required, but where the affairs of the bankrupt are so involved or complicated that the bankrupt alone cannot reasonably prepare a proper statement of affairs, the official receiver may, as an expense of the administration of the estate, authorize the employment of a qualified person to assist in the preparation of the statement;

[Emphasis added]

[62] Section 198(2) provides that a bankrupt who fails to comply with the requirements of s. 158 is guilty of an offence punishable on indictment or summary conviction. Section 198(1)(f) also provides that an offence occurs when a bankrupt "after or within one year immediately preceding the date of the initial bankruptcy event, fraudulently conceals or removes any property of a value of fifty dollars or more or any debt due to or from the bankrupt".

[63] Thus, the plaintiff engaged in conduct which was clearly illegal and in violation of the Act. However, this does not necessitate a finding that the parties' agreement is unenforceable, or preclude a remedy for the plaintiff. In John Swan, *Canadian Contract Law* (Markham: LexisNexis, 2006) at 754, the author states:

The law has tended to be merciful to the party who repents of any illegal purpose in time. Very often, the party protected in this way will be the more innocent (or less guilty) of the two. The effect of this attitude to illegality means that a party may have a locus poenitentiae, i.e., a time for repentance.

[64] In *The Law of Contracts* at ¶575, Professor Waddams notes:

The chief difficulty [with illegality] arises from the rule that not only is an illegal agreement void, but any property transferred under it is irrecoverable, as is any money paid. The rigour of this rule leads, as has been shown, to startling results and unexpected windfalls. Four exceptions have been recognized. First, where the transferor of the property "repents" of the illegal transaction before illegal performance and before the illegality comes to light the transferor will be permitted to recover any property transferred. [emphasis added]

[65] Mr. Walek was discharged from bankruptcy on March 7, 2006. In November 2006, he informed the trustee in bankruptcy of his failure to disclose the interest he held in Guardian prior to his bankruptcy. He also disclosed that he had commenced this action on November 22, 2005. The trustee decided not to pursue the action, but rather to assign the action and any interest Mr. Walek had in Guardian to him in exchange for payment to the trustee of \$100. I am of the view that, having admitted to the trustee in bankruptcy that he failed to declare all of his assets, Mr. Walek has remedied his misconduct. The trustee had the option at that point of assuming conduct of this litigation and pursuing the newly disclosed assets on behalf of Mr. Walek's creditors: *Shelson v. Gowling Lafleur Henderson LLP* (2004), 70 O.R. (3d) 171 at para. 30 (C.A.). The trustee, faced with the uncertainty and expense of a lawsuit, chose to sell to Mr. Walek the right to pursue this action. In these circumstances, should the defendants, who willingly participated in the plan to conceal assets from the trustee, now be permitted to rely on that concealment to avoid their contractual obligations to the plaintiff? In my view, to do so, would be to reward the defendants' improper conduct and to ignore the plaintiff's efforts to remedy his role in the scheme to avoid obligations to his creditors.

[66] As Waddams notes at ¶576,

a balance must be struck between competing policies. In recent years there has been a revival in the law of restitution. It is now recognized that the law must provide a remedy for unjust enrichment and this recognition is as much a public policy as any other. Several recent cases have refused to give effect to a defence of illegality on the ground that it would cause an unjust enrichment.

[67] This reasoning would appear especially relevant where the persons for whose benefit the provisions of the Act operate (the creditors), have, through the trustee, consented to and forgiven the plaintiff's misconduct. As Krever J. noted in *Royal Bank of Canada v. Grobman* (1977), 83 D.L.R. (3d) 415 at 432 (Ont. H.C.J.), the modern judicial view of illegality in the contracts field is a flexible one, and "the serious consequences of invalidating the contract, the social utility of those consequences, and a determination of the class of persons for whom the prohibition was enacted, are all factors which the Court will weigh".

[68] In summary on this issue, I am of the view that the plaintiff's initial failure to disclose to the trustee the benefits accruing to him under the contract in question is not a bar to enforcement of the agreement.

5. Is the agreement a nullity?

[69] Although I have found that the plaintiff remedied his failure to disclose his interest in Guardian to the trustee in bankruptcy, and is therefore not precluded by public policy consideration from pursuing this proceeding, the plaintiff's bankruptcy raises a more fundamental issue: whether these proceedings are a nullity because the plaintiff did not have the capacity to commence the action against the defendants.

[70] In this case, Mr. Walek made an assignment in bankruptcy on June 4, 2004. His interest in Guardian passed to the trustee at that point under s. 71 of the Bankruptcy and Insolvency Act, even though that interest had not been disclosed. On November 22, 2005, Mr. Walek commenced this action. At that point he did not have the legal capacity to do so because he was an undischarged bankrupt who no longer had an interest under the agreement, and therefore could not sue for breach. In effect, the rights he asserted in his statement of claim were the trustee's rights, not his.

[71] On March 7, 2006, Mr. Walek was discharged from bankruptcy. In December 2006 the trustee reassigned to Mr. Walek the rights under the agreement.

[72] The plaintiff relied on *G. Elmitt Construction Ltd. v. Kaplan*, a decision of this court, and the *Thompson v. Coulombe* (1984), 54 C.B.R. (N.S.) 54 case cited therein, in support of his submission that his discharge from bankruptcy and the reassignment of his interests under the agreement remedied his lack of capacity when this lawsuit was commenced. However, there is an essential difference between the facts in *Elmitt* and *Thompson* and the facts in the case at bar. In the former cases, the plaintiff had been discharged from bankruptcy at the time the action was commenced; in this case Mr. Walek remained an undischarged bankrupt when the proceedings began in November of 2005.

- [73] In *McNamara v. Pagecorp Inc.* (1989) 76 C.B.R. (N.S.) 97 (Ont. C.A.) the Ontario Court of Appeal held that an undischarged bankrupt lacked the legal capacity to bring an action in respect of property which the plaintiff and his wife had owned at the time of the bankruptcy and which had been sold back to him by the trustee. *McNamara* was cited with approval and this principle was addressed at some length by the Supreme Court of Canada in *Wallace v. United Grain Growers Ltd.*, [1997] 3 S.C.R. 701 at paras. 38-71. Mr. Justice Iacobucci also cited with approval the case of *Long v. Brisson*, [1992] 5 W.W.R. 185, in which the Alberta Court of Appeal held that an undischarged bankrupt has no capacity to initiate an action and, therefore, an action brought by the bankrupt is a nullity which cannot be validated by the trustee assigning the action to the bankrupt after his discharge from bankruptcy. What began as a nullity was held to remain a nullity, notwithstanding this assignment. These cases turn on the specific wording of s. 71 of the Bankruptcy and Insolvency Act which provides that, on bankruptcy, the bankrupt ceases to have any capacity to deal with property (including a cause of action).
- [74] The fact that the defendants did not raise the issue of whether the plaintiff had the capacity to commence these proceedings is not an answer to the problem: a nullity is incurable and cannot be waived by acquiescence or delay: *British Columbia Practice* (McLachlin & Taylor), 3rd ed. 2006 at 2-9.
- [75] There is one exception to the principle that an undischarged bankrupt has no capacity to initiate an action. Iacobucci J. in the *Wallace* case noted that s. 68(1) of the Bankruptcy and Insolvency Act authorizes an undischarged bankrupt to sue for property where such property is "salary, wages, or other remuneration". Mr. Walek's claim for quantum meruit compensation for services provided to Guardian would, in my view, be covered by this exception. Mr. Walek therefore had the capacity in November 2005, even as an undischarged bankrupt, to commence that portion of these proceedings relating to recovery of the quantum meruit claim under the agreement.
- [76] In my view, if even one of the claims advanced is not a nullity, there exists a valid action and the potential for the making of remedial orders. In that respect, the case at bar differs from *B.N.R. Holdings Ltd. v. Royal Bank of Canada* (1992), 74 B.C.L.R. (2d) 332 (C.A.) para. 31, which holds that if the plaintiff has no cause of action at the time the writ is issued, that failure cannot be cured nunc pro tunc.
- [77] If Mr. Walek had commenced this action in relation to the quantum meruit claim only, (or if the defendant had applied to strike out the other claims in the early stages of these proceedings, leaving only the quantum meruit claim), I am of the view that Mr. Walek, after being discharged from bankruptcy and after receiving the assignment from the trustee, could have applied to amend his pleadings to include the rest of the claims. At that point the plaintiff would have had the legal capacity to both commence an action, and to pursue the particular claims relating to the agreement. Had such an application been made, it is likely that the court would have allowed those amendments, applying the usual test under Rule 24. With leave of the court, amendments to pleadings may be made at any stage before

judgment is entered. I am therefore of the view that it is open to me to permit such amendments nunc pro tunc, effective as of the date of the reassignment of the chose in action to Mr. Walek which post-dated his discharge from bankruptcy, and I so order.

- [78] In my view, this is the appropriate course of action, particularly in light of the alternative. Were I to find that the plaintiff's action is a nullity other than with respect to the quantum meruit claim, it would be as though those other claims had never been made. Since the alleged breaches arose in September or October of 2005, the six-year limitation period has not expired, and it would be open to the plaintiff to commence a new action addressing the remaining claims. Another trial would have to be held, and the litigants would be put to the expense of re-hearing and re-arguing what has already been put before me over nine days of trial. In the end, the only substantial effect of an order dismissing most of the plaintiff's case as a nullity would be an increase in the time, expense, and effort required to resolve the issues in dispute between the parties.

DIRECTIONS

- [79] Pursuant to s. 227(3)(a) of the Business Corporations Act, I direct Ms. Mainardi to transfer 20 per cent of the shares held in her name to Mr. Walek within 14 days of the date of these reasons for judgment
- [80] After the transfer of these shares, Mr. Walek will be a minority shareholder. His right to repayment of his shareholder's loan, deferred compensation, and to the transfer of a further 10% stake in Guardian from Ms. Mainardi, are all dependent on Ms. Mainardi's \$75,500 loan being repaid by Guardian. In light of the past oppressive conduct of the defendants, I make the following additional orders under s. 227(3) of the Business Corporation Act:
1. Ms. Mainardi is to cause Guardian to prepare monthly and year end financial statements and to provide copies of those statements to Mr. Walek within 15 days of those statements being prepared;
 2. Ms. Mainardi and Guardian are to make available to Mr. Walek for inspection all bank statements, ledgers, and any other documents, whether electronic or paper, from which the monthly financial statements have been prepared; such inspections are to take place up to four times each year, on 24 hours notice until Ms. Mainardi's and Mr. Walek's shareholder's loans have been repaid, and Mr. Walek has been paid the \$35,000 due to him for his management work.
 3. Ms. Mainardi and Guardian are to provide copies of the company's income tax returns to Mr. Walek upon filing and are to provide copies of assessments and reassessments to him within 7 days of receipt of same.

COSTS

- [81] The plaintiff is entitled to his costs from the defendants at Scale B.

The Honourable Madam Justice L. A. Fenlon

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