

CANADA / JUDGMENT

Zhou v. Li

2019 BCSC 188

COURT

Supreme Court of British Columbia

DECIDED

21 February 2019

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2019 BCSC 188 Zhou v. Li

IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation:

Zhou v. Li,

2019 BCSC 188

Date: 20190221

Docket: S192060

Registry: New Westminster

Between:

Zi Hao Zhou

Plaintiff

And

Zhi Yuan Li

Jian Fu

Morecan Auto Spa Limited

Morecan Auto Detailing Ltd.

Morecan Auto Group Corporation

Defendants

Before: The Honourable Madam Justice Norell

Reasons for Judgment

Counsel for the Plaintiff:

D. Chen

The Defendants: Zhi Yuan Li, Morecan Auto Spa Ltd., Morecan Auto Detailing Ltd., and Morecan Auto Group Corporation

No appearance

The Defendant: Jian Fu

No appearance except

August 27, 2018

Place and Dates of Trial:

New Westminster, B.C.

August 27-28 and 31, 2018, February 11, 2019

Place and Date of Judgment:

New Westminster, B.C.

February 21, 2019

Introduction

- [1] In late January, 2016, the plaintiff Mr. Zhou purchased from the defendant Mr. Li 35% of the shares of a company now called Morecan Auto Spa Limited ("Morecan") for \$240,000. The company operated a luxury auto detailing business on Minoru Blvd. in Richmond, BC. Upon purchase of the shares, Mr. Zhou became a director of the company, but he had limited involvement in its management. He left the management of the company to Mr. Li.
- [2] A little over a year after Mr. Zhou bought shares in Morecan, the business closed.
- [3] Mr. Zhou seeks judgment against Mr. Li, alleging:
 - a) fraudulent misrepresentations regarding the business; and
 - b) breach of an alleged fiduciary duty owed by Mr. Li as a director to Mr. Zhou as a shareholder of Morecan.
- [4] In terms of remedy, Mr. Zhou seeks a constructive trust over a strata property in Richmond, BC (the "Richmond property"), or alternatively judgment in the amount of \$240,000. He also seeks an equitable tracing of funds and a declaration that the defendant Mr. Jian Fu holds the Richmond property in trust for Mr. Li.
- [5] Mr. Li did not attend the trial.

- [6] Mr. Li filed a counterclaim against Mr. Zhou alleging breach of a shareholders' agreement and breach of fiduciary duty. As no evidence was led to establish any of these allegations, the counterclaim is dismissed.
- [7] Mr. Jian Fu is a defendant in the proceedings but no monetary judgment is being sought against him. He is named because he is on title to the Richmond property. He did not file a response to civil claim and was called as the first witness by Mr. Zhou. He did not participate further in the trial.
- [8] The actions against the defendants Morecan Auto Detailing Limited, and Morecan Auto Group Corporation were discontinued at the commencement of trial. No evidence or claim was made against Morecan Auto Spa Limited, and the action against it is dismissed.
- [9] There were three witnesses at trial: Mr. Zhou, Mr. Fu, and Mr. Shu Heng Xu. Mr. Xu worked at the business prior to and after Mr. Li's and Mr. Zhou's involvement.

Allegation of Fraudulent Misrepresentations

- [10] Mr. Zhou alleges Mr. Li made three fraudulent misrepresentations:
- a) Mr. Li had invested \$700,000 in Morecan: \$200,000 to purchase the shares from the previous owners of the business, \$300,000 for renovations, and the remainder for equipment;
 - b) Morecan was earning \$20,000 in a good month, and \$10,000 in a poor month; and Mr. Zhou would get \$5,000 per month return; and
 - c) Mr. Li was diligent and focused on developing Morecan's business. This is alleged to be representation by conduct.

Legal Principles

- [11] The elements of fraudulent misrepresentation were reviewed in *Ma v. Nutriview Systems Inc.*, 2014 BCSC 725 at paras. 173-175, *aff'd* 2016 BCCA 4, leave to appeal *ref'd* [2016] S.C.C.A. No. 83:
- [173] The test for fraudulent misrepresentation was set out by Bauman J.A., as he then was, in *Catalyst Pulp and Paper Sales Inc. v. Universal Paper Export Co.*, 2009 BCCA 307 at para. 55:
- [55] Counsel for UPE cited G.H.L. Fridman, *Law of Contract in Canada*, 4th ed. (Scarborough: Carswell, 1999) at 309-310, where the learned author described a case of fraudulent misrepresentation as consisting of four elements:
- (a) the wrongdoer must make a representation of fact to the victim;
 - (b) the representation must be false in fact;
 - (c) the party making the representation must have either known it was false or made it recklessly without knowing whether it was true or false; and

(d) the victim must have been induced by the representation to enter into the contract.

[174] In G.H.L. Fridman, *The Law of Contract in Canada*, 6th ed. (Toronto: Carswell, 2011) at 284, Professor Fridman described the distinction between fraudulent and non-fraudulent misrepresentations. He stated that a fraudulent representation "is one which is made with knowledge that it is untrue and with the intent to deceive."

[175] At 287, Professor Fridman went on to state that an allegation of fraud is a very serious matter:

Clearly, while the courts will protect an innocent party from gross fraud, they will not attempt to protect a contracting party from all types of conduct. In accordance with the general principles of the law of contract, a party is expected to look out for himself, and make his own bargains. If he has done foolishly, that is his own fault and he is left to his own devices. Only from totally improper conduct, in this instance fraud, will he be granted protection and a remedy by the courts.

[12] A misrepresentation does not need to be the only or even the most significant inducement for the plaintiff's actions. It is sufficient if a misrepresentation is an inducing cause: *Battrum v. MacKenzie*, 2010 BCSC 1285 at paras. 24-25.

[13] In *Kripps v. Touche Ross & Co.* (1997), 33 B.C.L.R. (3d) 254 at para. 103, the Court stated as follows with respect to the inference of reliance:

It is sufficient, therefore, for the plaintiff in an action for negligent misrepresentation to prove that the misrepresentation was at least one factor which induced the plaintiff to act to his or her detriment. I am also of the view that where the misrepresentation in question is one which was calculated or which would naturally tend to induce the plaintiff to act upon it, the plaintiff's reliance may be inferred. The inference of reliance is one which may be rebutted but the onus of doing so rests on the representor.

Mr. Zhou

[14] At the time of the events of this lawsuit, Mr. Zhou was 26 years old and had limited work and business experience. He immigrated to Canada in early 2008 and attended senior high school. From 2009 to 2011 he attended Douglas College and studied business. From 2014 to mid-2015 he worked as a realtor's assistant, taking clients to open houses, and introducing new immigrants to Vancouver. At the time he purchased shares in Morecan from Mr. Li in early 2016, he had no other work experience, no experience in running or buying a business, and no experience in the auto detailing business.

[15] He met Mr. Li in mid-2015 through a mutual friend. He first became aware of the auto detailing business on Minoru Blvd. in August 2015. At the time it was called CSC Auto Spa Club Inc. ("CSC"). Mr. Li invited him to a barbecue and said he was opening a new business. Mr. Li showed Mr. Zhou the premises which were under renovation. Mr. Zhou took an interest in the business and from time to time Mr. Li would update him on the progress of

the business. Mr. Zhou thought Mr. Li seemed like a hard-working person and this might turn out to be a successful business.

- [16] Toward the end of 2015, Mr. Li telephoned Mr. Zhou and said a few people were to going to join the company and asked if Mr. Zhou was interested in joining as well. Mr. Zhou told him he was very interested. Mr. Li said he did not want to sell a lot of his shares, and asked Mr. Zhou how many shares he would want if he were to join. Mr. Zhou said it was up to Mr. Li.
- [17] After that call, Mr. Zhou went to Mr. Li's office a few times and Mr. Li told him about the future development of the business. Mr. Li offered him 35% of the shares in Morecan for \$240,000. Mr. Li told him that he came to this figure as the total investment in the company was about \$700,000. Mr. Li said he spent approximately \$200,000 to purchase the business, almost \$300,000 for renovations, and the rest to purchase equipment.
- [18] As for the future development of the business, Mr. Li told him that the "business was ready to start operating". The detailing, especially the coating service which was the most profitable component of the business, was already fully booked. He said, "while he was operating the business, he knew already, when it is going well, then the net profit could be as high as \$20,000 per month". Mr. Li said that even when it is raining and the car wash is not as busy, they could still net \$10,000 per month or more. Based on the proposed shareholding, Mr. Li would be making \$5,000 per month.
- [19] Mr. Li told Mr. Zhou that if he trusted him, he could let Mr. Li run the business. Mr. Zhou said he had no experience in the auto detailing business. Mr. Li told him the only thing he would do is receive the money Mr. Li is going to distribute to him. Mr. Zhou said he believed Mr. Li. He explained this was because Mr. Li often posted pictures on social media of him working very late at night and there were many cars at the premises. Mr. Zhou said he was led to believe Mr. Li was working very hard to try to make this business a success.
- [20] Mr. Zhou did not ask to see any documents regarding what Mr. Li spent to buy the shares from the previous owners, or for renovations or equipment. He did not ask for or review any company financial statements. He said Mr. Li told him orally what he had invested and he trusted him.
- [21] Mr. Zhou paid \$10,000 cash to Mr. Li and the remaining \$230,000 by way of bank draft payable to Mr. Li. Mr. Li admits payment of these funds in the response to civil claim. On January 28, 2016, Mr. Zhou received 35,000 shares in the company. He paid the investment funds a day or two prior to this. There was no share purchase agreement or shareholders' agreement. Mr. Li told Mr. Zhou that simpler would be better and that it would save them money not to have an agreement drafted.
- [22] Since he purchased the shares, Mr. Zhou has never received any funds as return on his investment. Mr. Zhou expected \$5,000 to be paid to him at the end of each month. For the first three months, Mr. Li approached him and told him the money was not paid for various reasons: bad weather and lack of customers; poor weather and customers who did not pay;

some extraordinary expenses; and finally the alleged incompetence of the general manager of the company, Mr. Xu. As Mr. Li had approached Mr. Zhou on his own initiative, Mr. Zhou told himself to be patient. In May, Mr. Li left for China for two months and told Mr. Zhou he would investigate Mr. Xu further when he returned.

- [23] Mr. Li returned from China at the end of June or early July, 2016. In early July, Mr. Li asked Mr. Zhou to go to Morecan's bank to obtain funds for the employee payroll. Mr. Zhou went to the bank. This was the first time he had accessed the company account. He attempted to withdraw cash. He thought there would be considerable funds as summer was the busiest season for the business. The teller told him there were insufficient funds. He was surprised and asked the teller for statements from February to June 2016. He reviewed the statements and thought there were many withdrawals from the account, such as a purchase at Holt Renfrew, which were not related to the business. As there were only two Morecan debit cards, and he had one and Mr. Li had the other, he was concerned. He had another concern. Prior to Mr. Li leaving for China, customers had purchased membership cards in the business for cash. He did not see any deposits for these purchases.
- [24] Mr. Zhou went to Morecan's office to see Mr. Li. Mr. Xu and another employee were with Mr. Li. He did not want to confront Mr. Li in front of these people. Because he and Mr. Li were partners he wanted to talk to him in a friendly way. He did not ask why the membership card cash was not deposited. There was no cash on the premises and he believed Mr. Li used the cash. He asked Mr. Xu to identify all withdrawals on the bank statements that were not business expenses. The total was almost \$20,000. Mr. Li offered an explanation. He said he had some personal items he needed to purchase and he used the company card and would return the funds later. He also said that because the company did not have enough money to pay the employees, he would take care of it.
- [25] The next month Mr. Zhou did not hear anything about employees not getting paid on time, so he thought the matter was resolved. Because this was a young partnership, and previously Mr. Li would come to him with explanations, he continued to wait for money.
- [26] In September 2016, Mr. Li and Mr. Zhou discussed Mr. Xu's performance, and Mr. Li said that as Mr. Xu had been a long-time employee they should give him time to improve but not pay him wages. Mr. Li then said none of this was important because he had found a new investor to join the company and he was thinking of relocating the company to a larger place. By this time, Mr. Zhou was suspicious. He had not received any money and Mr. Li's work attitude had changed. Prior to and for a little time after Mr. Zhou joined the company, Mr. Li was very active and making an effort. Later on, he was coming in to work late and partying, and not focusing on the business, even when the company was not making money.
- [27] Mr. Zhou told Mr. Li that since he had a new investor and Mr. Li wanted a new location, and Mr. Zhou did not understand the business, he would not continue with his investment. Mr. Li told him this was no problem. He said Mr. Zhou was his friend and he accepted his request. Mr. Li said he would refund all of the money and increase the amount by 30%. Mr.

Zhou told Mr. Li he did not need the 30%. After the meeting, Mr. Zhou made the calculation and determined he could get back \$300,000. A few days later Mr. Li told Mr. Zhou that after he received the investment, he would return all of the money plus 30%. He said Mr. Zhou was his first partner and the first to have faith in him.

- [28] During the autumn of 2016 Mr. Zhou did not attend the business very often because he was waiting for the money to be refunded to him. During this time there were a few conversations between Mr. Zhou and Mr. Li. In November, Mr. Zhou saw a "for sale" sign on the property. Mr. Li told him the landlord of the premises decided to sell the property and because of this new development he was now seeking to find a new investor and he had already found a new location. At the end of the year Mr. Li told him he was busy trying to sell the business, and had not received the money from the new investor. Mr. Zhou asked if he could help with the process of selling the business because Mr. Zhou had friends who were brokers. Mr. Li said there was no need to do so because he was already in touch with a realtor and again promised him return of his funds. In the New Year Mr. Zhou followed up and Mr. Li told him he was busy with selling the business, and had a new location and was busy with that too, and again promised return of funds as soon as possible. Mr. Zhou said he was anxious, but chose to believe Mr. Li. Mr. Li also offered him 10% of the new business.
- [29] In March or April 2017 Mr. Zhou attended Morecan's office and an employee told him the business was shutting down. The employee told him the day prior an accountant had come to the premises for a bankruptcy liquidation. Mr. Zhou was unaware of this and did not know what to think. He said he always thought Mr. Li was trying to get the business sold and return his money. Mr. Zhou became angry and thought he had been duped. He called Mr. Li and asked him to come to the office. Mr. Li came and said that he had hired the accountant because he just wanted to find out options - if they could just shut down the company. He told Mr. Zhou that he was not concerned he would not have money to pay him if the business was not sold, because he would have money from the new investment.
- [30] After this, Mr. Zhou lost faith completely. At some time later, Mr. Xu talked to him and asked if he knew who the company accountant was because Mr. Xu needed a T4 slip to file his tax return. Mr. Zhou asked Mr. Xu if he knew Mr. Li was going to open a new business. Mr. Xu told him the new company had already been registered. Mr. Zhou asked what the company name was and Mr. Xu did a search for him and showed it to him. Three companies showed up - all with Morecan in the name. This is when Mr. Zhou first found out that Mr. Li had already changed the name of Morecan. The name of Morecan (when Mr. Zhou bought shares) was Morecan Auto Group Limited, and Mr. Zhou had changed the name to Morecan Auto Spa Limited.

- [31] Mr. Zhou called Mr. Li and asked him why he did not tell him that he had these businesses with similar names. Mr. Li told him it was because the new investor really liked the company name and logo so they decided to use them. When Mr. Zhou asked for more detail Mr. Li said he was busy and would call him the next day. He never called. Mr. Zhou then consulted a lawyer.

Mr. Shu Heng Xu

- [32] Mr. Xu worked for both CSC and Morecan. He and a partner now own a different auto detailing business in Richmond. In late 2014 or early 2015 he started working for CSC. He washed cars, helped the owners manage the company, and helped with transactions in English such as getting a City licence. Mr. Xu also worked with the accountant for CSC for payroll and banking. Mr. Xu was given a 5% interest in CSC when he was hired by the owners of CSC. The owners had asked him to work for them, but he had planned to go to school. They said they needed his help. Mr. Xu never paid for those shares.
- [33] The revenue of CSC for the 10 months it operated, up to August 2015 when Mr. Li bought the shares, was about \$130,000. Mr. Xu did not know the profit but said rent was approximately \$6,000 per month and the employee payroll was about \$5,000 per month.
- [34] CSC changed its name to Morecan after Mr. Li purchased the business in mid-2015. Mr. Xu continued to work in the business after Mr. Li purchased it. He said he did anything that Mr. Li could not or would not do. This included washing and detailing cars, banking, working with the accountant, and ordering. He last worked for Morecan in either December 2016 or January 2017. He quit Morecan because he was working long hours and not always getting paid on time.
- [35] Mr. Li was a CSC customer. Mr. Li started negotiating the purchase of CSC in June or July 2015 and by August 2015 the sale completed. Mr. Xu was present at a meeting with Mr. Li and the two owners of CSC in July 2015 when they were negotiating the purchase price. Mr. Li asked him to be at the meeting. There was a discussion about the sale of the shares for approximately \$50,000, and assumption of the debt of the company (taxes and overdue rent) which was \$30,000 to \$40,000. In total, the purchase price discussed was under \$100,000 but he does not know the exact numbers as he was not present when the final agreement was made.
- [36] When Mr. Li bought the business Mr. Xu retained his 5% of the shares. Mr. Xu said he offered to give the shares back to Mr. Li, but Mr. Li said he did not have to. Mr. Xu did not testify he was a director of Morecan, but he identified a directors' resolution, which he signed, authorizing the transfer of shares to Mr. Zhou.
- [37] After Mr. Li purchased CSC, he renovated the premises from August to December, 2015 and changed the name of the business to Morecan after the renovation. During this time, the business closed and then later it washed cars for some friends but was not operating as a business. Mr. Xu was only working one or two days a week during this time to sometimes

help Mr. Li with renovations. Mr. Li told him the cost of the renovations was \$150,000. In December 2015, or January 2016, there was a "soft" reopening of the business. Mr. Xu described it as soft because not everything was done such as product descriptions for customers.

- [38] Mr. Xu met Mr. Zhou in August 2015 soon after Mr. Li took over the business. Mr. Li had hosted a barbecue event and Mr. Zhou was a guest. Mr. Xu first learned that Mr. Zhou was going to become an owner of the business after it reopened in January 2016. Mr. Li called him into his office and told him. At the time Mr. Li was doing a calculation of the value of the shares and a price. Mr. Li told him that Mr. Zhou was not going to manage the business but was going to invest and take dividends. Mr. Li asked Mr. Xu his opinion of the value of the shares and he told Mr. Li it was up to him. Mr. Li started to do a calculation of what he had invested in the company and for the renovations, and it was approximately \$200,000, and then Mr. Xu left. He did not know for how much Mr. Li was going to sell shares. Not long after that Zhou became an owner.
- [39] Mr. Xu described how Mr. Li managed the business over time. During the negotiations for Mr. Li to purchase the business and at first after the purchase, he appeared very motivated to make a successful business. Mr. Li was there every day. Shortly after, he became less involved. After a time Mr. Li was constantly making excuses not to pay the employees on time. He said Mr. Li "did things for show" to make it look like the company was fully booked, when there was not that much business. He would post pictures on the internet to make it look like the company was busy. Mr. Xu was present when Mr. Li would talk to customers. He would tell customers that the business was very busy and the coating service was fully booked for a long time. He heard Mr. Li tell others that the company was profitable, but he did not hear him give any numbers.
- [40] Mr. Xu testified that after Mr. Zhou became an owner, Mr. Li really started to "let off" and became less interested in the business. Mr. Li would not come to the business until between three and five o'clock pm and would have friends upstairs every night playing video games and poker. Mr. Li was not supervising the employees. Everything started to get slowly worse. The employees, taxes and rent were not being paid on time. Every month the company was short of money to pay its employees and Mr. Zhou and Mr. Li had to put money into the business. Mr. Zhou gave him a cheque to deposit into the company account to pay the employees. Mr. Zhou did not give evidence of this and his counsel said he was not seeking return of such funds.
- [41] Mr. Xu talked to Mr. Li multiple times about the situation. At one point, in the late summer of 2016, Mr. Li said to Mr. Xu: "Do you think that I am losing money?" Mr. Xu said he thought he was. Mr. Li said to him that he had earned back his money already. He said Mr. Zhou's investment more than covered the costs he put into the company and the money he had to put in after. After that, Mr. Xu did not go to Mr. Li anymore with his concerns.

- [42] Mr. Xu said he had access to the bookkeeping records while at Morecan. When a car came in, the charge was written by hand in a book. He did payroll every two weeks. Mr. Xu met with Morecan's accountant to do payroll and taxes and give him receipts. This was the same accountant CSC had. He would pay invoices (often cash given to him by Mr. Li). As far as he knew, there were no financial statements prepared and the company never filed a tax return. He never saw a profit and loss statement. He recalls the accountant having a hard time. The accountant required invoices for expenses and for a lot of the expenses Morecan did not have receipts. Mr. Xu only saw bank statements twice - once when the accountant required the statements, and once when Mr. Zhou showed the statements to him and Mr. Li and they went through them. He did not see any cash deposits for customers who had paid cash.
- [43] Mr. Xu said revenue for Morecan was \$5,000 to \$7,000 per month, and for two or three months, it was in the range of \$8,000 to \$10,000 per month. There never was a total calculation of revenue as there was for CSC. The rent was \$6,000 or maybe a little higher. The payroll was about \$8,000 to \$10,000 per month, plus possibly more for another employee, but Mr. Xu does not know if this other employee was paid.
- [44] Mr. Xu said Morecan was not profitable. Some transactions were in cash as the clientele were wealthy, and either the clients offered to pay in cash or Mr. Li would ask to be paid in cash. This money did not go into the company account. Mr. Xu said he knew of \$12,000 in cash transactions during the time Mr. Li operated the business from August 2015 to December 2016. Mr. Xu also thought there were wasted expenses. He saw expense items on a statement Mr. Zhou showed him that could not be company expenses, such as a charge at Holt Renfrew.
- [45] In October or November 2016, a "for sale" sign appeared on the property. He does not think the sign had any effect on the business because there were rarely any new walk-in customers at that time and the customer base consisted of old customers and friends.
- [46] In late 2016, Mr. Li sent Mr. Xu and another employee named Jerry to a different accountant. Mr. Li said he had a potential new investor. He and the investor wanted to open a new business. He asked Mr. Xu to talk to the accountant about how to put Morecan into bankruptcy and how to put a potential new investment into his own account. The accountant wanted more information. Mr. Xu said he did not understand the whole idea. Mr. Xu left Morecan shortly after that.
- [47] Mr. Li subsequently opened a new auto detailing business on Beckwith Road in Richmond. Mr. Xu went there in the summer of 2017 and Mr. Li offered him a job.

BC Corporate Registry Records

- [48] Certified BC Corporate Registry records show that CSC was incorporated June 23, 2014, that it changed its name to Morecan Auto Group Inc. on January 2, 2016, and changed its name again to the Morecan Auto Spa Limited on December 2, 2016.
- [49] Mr. Li incorporated Morecan Auto Group Corporation on March 12, 2017. Mr. Li is a director.
- [50] Mr. Li incorporated Morecan Auto Detailing Ltd. on May 31, 2017. Mr. Li is a director.

Analysis

- [51] I find that Mr. Li represented to Mr. Zhou that he had invested approximately \$700,000 into the business, and that this sum was comprised of approximately \$200,000 for shares in CSC, almost \$300,000 in renovations, and the rest in equipment.
- [52] I find that this is a statement of fact and it is false, and that Mr. Li made the statement knowing it was false. Mr. Xu's evidence indicates that Mr. Li's investment was in the range of \$250,000 consisting of approximately \$100,000 being negotiated to purchase the shares in CSC, although he was not present for discussion of the final numbers, and \$150,000 for renovations. Counsel for Mr. Zhou also refers to the statement of Mr. Li to Mr. Xu that he was making money because he had already received from Mr. Zhou more than he had invested in the company and subsequent payments he had to make. I am cautious that these are hearsay statements admitted under an exception as an admission of a party against interest. However, counsel for Mr. Zhou refers to paragraph 11 of the response to civil claim where Mr. Li pleads that he paid \$110,000 for the shares in CSC. I also note paragraph 13 where Mr. Li pleads that he invested approximately \$320,000 in renovations. On Mr. Li's own pleadings, he didn't invest \$700,000.
- [53] I find that the representation that Mr. Li had invested \$700,000 is a material representation and a statement that induced Mr. Zhou to purchase the shares for \$240,000. The sum of \$240,000 is 34.3% of \$700,000. I find Mr. Zhou would not have invested \$240,000 for a 35% interest in Morecan if he had been told the true information, which was that Mr. Li's investment was either in the range of \$250,000 or even up to \$430,000 which is what Mr. Li has pleaded in his response to civil claim. I find Mr. Zhou would not have made the investment at all if he had been given the true information by Mr. Zhou.
- [54] With respect to the statements regarding profitability, Mr. Zhou did not say that Mr. Li told him the company was currently making \$20,000 per month. Mr. Li told him that the business was ready to start operating. As the company was not yet operating (or at least not to full extent while renovations were ongoing) I find this was a hopeful prediction of future income, not a statement of fact. As such, the statements are not actionable: *Regional District of Okanagan - Similkameen v. Blackwell Stores Ltd.*, 2000 BCSC 425 at para. 58; *aff'd* 2001 BCCA 369. Mr. Zhou did not make a claim for negligent misrepresentation, alleging special knowledge or skill on the part of Mr. Li.

- [55] Counsel for Mr. Zhou argues that there was no basis to make a statement regarding income as high as \$20,000 per month. He argues that to make the statement that in a good month the company could make a certain amount implies that the company has made that profit before. I do not agree. Mr. Zhou knew the premises had been renovated and had not been operating, or at least operating at full capacity during renovations. Mr. Li told him that the business "was ready to start operating" and that revenue "could be as high as" \$20,000.
- [56] While the evidence of Mr. Xu was that CSC was not making much if any money, the evidence before me is not sufficient to establish that Mr. Li was fraudulent in making such a prediction. He had renovated the business and up to that point according to both Mr. Xu and Mr. Zhou was working hard in the business to make it a success.
- [57] Finally, Mr. Zhou's counsel argues that Mr. Zhou fraudulently represented by conduct that he was diligent and focused on developing the business. He argues that he posted pictures on social media of himself working late at night, and when friends came by Mr. Xu said he would tell the friends that the business was profitable and he was busy.
- [58] Fraudulent misrepresentation can occur by words or conduct intended to cause the plaintiff to believe a nonexistent fact: *RC Hotel Ventures Ltd. v. Meristar Sub 2C, L.L.C.*, 2008 BCSC 918 at para. 20. However, no case law was cited to me where a fraudulent misrepresentation was established on facts similar to this case: a posting of pictures showing an individual working, when it is alleged the individual was not truly devoted to work. Even if such posting could be considered a representation of fact, I find Mr. Zhou has not established it was false. Both Mr. Xu and Mr. Zhou testified that Mr. Li was initially focused on the business and working hard at it. The fact that he later was not focused on the business is not evidence of the falsity of his representation by conduct at the time the representations were made. If he made representations to clients and friends that the business was profitable and busy, that does not assist Mr. Zhou, because he did not give evidence that those representations were made to him.
- [59] In summary, I find that Mr. Zhou has established that Mr. Li made a knowingly false statement of fact regarding the investment he had made in Morecan, that this induced Mr. Zhou to purchase the shares, and that if Mr. Li had not misrepresented the facts, Mr. Zhou would not have purchased the shares. I will discuss remedies further below, but find in this case the measure of damages for the fraudulent misrepresentation is the lost investment of \$240,000.

Allegation of Breach of Fiduciary Duty

- [60] Mr. Zhou's counsel argues Mr. Li, as a director, breached a fiduciary duty to Mr. Zhou as a shareholder, and as a result Mr. Zhou suffered a loss. The loss is the diminution in the value of his shares.

[61] Mr. Zhou refers to s. 142 of the Business Corporations Act, S.B.C. 2002, c. 57, and Mr. Li's failure to act in the best interest of the company. Section 142(1) of the Business Corporations Act states:

142 (1) A director or officer of a company, when exercising the powers and performing the functions of a director or officer of the company, as the case may be, must

- (a) act honestly and in good faith with a view to the best interests of the company,
- (b) exercise the care, diligence and skill that a reasonably prudent individual would exercise in comparable circumstances,
- (c) act in accordance with this Act and the regulations, and
- (d) subject to paragraphs (a) to (c), act in accordance with the memorandum and articles of the company.

[62] In *Robak Industries Ltd. v. Gardner*, 2007 BCCA 61 [Robak], the BC Court of Appeal held that the rule in *Foss v. Harbottle* (1843), 67 E.R. 189--that only the company and not individual shareholders, may sue for wrongs to the company--precludes a shareholder from bringing a claim for diminution in the value of a shareholder's shares in a company unless the shareholder can establish both: (1) an "independent relationship" with the wrongdoer who caused the shareholder's loss; and (2) that the loss is "independent" from that of the company to whom the wrong has been done (see para. 38).

[63] In *Shon v. Argo Mezzanine Financing No. 3 Ltd.*, 2014 BCSC 2117, the Court applied the test in *Robak* to strike out claims of breach of fiduciary duty and negligence made by a shareholder as against a corporate director. The Court found that, even if there was an independent relationship, there was no independent loss because the diminution in the value of the shareholder's shares was a loss suffered by the company and all of its shareholders, not a loss to the shareholder-plaintiff in particular.

[64] At para. 53 of *Shon*, the Court states:

[53] The various cases relied upon by S. Shon in asserting the existence of a reasonable claim in respect of her allegations of breach of fiduciary owed to her as a shareholder by Hong as a director and officer of *Argo No. 3* establish to my satisfaction that:

- 1) Fiduciary duties can be owed by directors to shareholders where there is a special relationship of trust and dependency between the plaintiff shareholder and the defendant director where the director was seeking to take unfair advantage of the shareholder for personal gain. See: *Dusik and Malcom*.
- 2) A director may assume a fiduciary duty towards a shareholder on the facts of a particular case including in the case of closely held corporations. See: *Valastiak*; and *Coleman v. Myers* [1977], 2 N.Z.L.R. 225 (New Zealand Supreme Court) cited with approval by our Court of Appeal in *Dusik*.

- 3) Whether a fiduciary relationship will arise between a director and a shareholder will depend on the facts of a particular case. See: Samos at para. 184 and cases cited therein.
- [54] What is most apparent from those authorities and others on the non-exhaustive situations in which fiduciary duties have been found to be owed by directors to shareholders is that the question of whether fiduciary duties exist is a fact dependent inquiry.
- [65] Mr. Zhou's counsel argues that this was a closely held corporation with only three shareholders and there was a "legal dependency" on the part of Mr. Zhou. He says Mr. Zhou relied upon Mr. Li to manage the company and that Mr. Zhou was simply an investor and agreed he would not get involved in operating the business. He further argues that Mr. Li only held 35% of the shares of Morecan. Mr. Zhou's counsel argues that as a director Mr. Li had a duty to act honestly and in good faith. He argues that, instead: Mr. Li misappropriated funds and took cash from membership cards which was not put into the company account; did not devote himself to the business; incorporated two new companies with very similar names that were acting in competition with Morecan and would have taken any goodwill associated with the name; and investigated putting the company into bankruptcy. In summary, Mr. Zhou's counsel argues that Mr. Li let the company go to waste, had no regard for the company, and that his personal agenda was to get investors. He argues that Mr. Li painted a rosy picture to attract gullible investors. However, Mr. Zhou's counsel does not argue that Mr. Li socializing with individuals in the evening was necessarily harming the business, because that may have been a legitimate way to market the business.
- [66] The factors cited to me by counsel for Mr. Zhou do not establish an independent duty owed to Mr. Zhou by Mr. Li. This is not a situation where the parties are family members, or there is a trust agreement between them. His discussion with Mr. Li that he would let Mr. Li run the company does not rise to the level of a special dependency that would found an independent duty. Further, Mr. Zhou's loss in the value of his shares is identical to the loss to the company, and to the loss in the value of Mr. Li's shares.
- [67] Mr. Zhou has not established a claim against Mr. Li for breach of fiduciary duty for the loss in value of his shares. The claim is not sustainable under the rule in *Foss v. Harbottle*.

Remedies

- [68] Mr. Zhou seeks a remedial constructive trust over the Richmond property. Alternatively, if the court does not grant a constructive trust, Mr. Zhou seeks a monetary judgment against Mr. Li.
- [69] There is a further issue related to the constructive trust: who is the beneficial owner of the Richmond property? Mr. Zhou also seeks a declaration that the Richmond property is being held by Mr. Fu in trust for Mr. Li. A State of Title Certificate for the Richmond property states Mr. Fu is the owner of an undivided 99/100 interest, and Mr. Li is the owner of an undivided 1/100 interest. The Richmond property is a strata lot encumbered by: various covenants, easements and statutory rights-of-way; a mortgage in favour of the Canadian

Imperial Bank of Commerce ("CIBC"); certificates of pending litigation registered by Mr. Zhou and CIBC; a Strata Property Act lien; two Property Transfer Tax Act liens; and a judgment registered by a law firm against Mr. Li's interest.

- [70] Mr. Fu is now 26 years old. He said he paid nothing toward the Richmond property. He said he signed the documents to put the property in his name "unwittingly" as Mr. Li "asked me to hold the interest in trust for him". When asked why he did this he said it was "based on the deception" of Mr. Li. They were friends. He said he "did not tell me the whole truth about" the property. He believed he was still on title but Mr. Li was "withholding information" from him.
- [71] Mr. Zhou testified that Mr. Li told him that he was purchasing property and he did not want to pay the 15% foreign buyer's tax. He said he wanted to find someone with a permanent resident card to hold the property for him. He said he needed Mr. Fu to help him so he would be spared paying the tax. He said Mr. Fu has a permanent resident card.
- [72] Mr. Xu knows Mr. Fu. He has no direct knowledge of how Mr. Fu became a 99/100 owner of the Richmond property. However, Mr. Xu said that Mr. Li had previously asked him to be a 99/100 owner of the property so that Mr. Li could avoid paying the 15% foreign buyer's tax because Mr. Xu has permanent resident status. Mr. Xu asked Mr. Li if it was legal and decided not to do it. Mr. Xu helped Mr. Li move into the Richmond property which is in an area of Richmond called River Green.
- [73] The basis of Mr. Zhou's claim for a constructive trust is that in the autumn or near the end of 2016 Mr. Li talked to Mr. Zhou about wanting to purchase a property. Mr. Li said he was going to use money to be transferred from China but it would be a "hassle" to do so, and that part of the money would be from Mr. Zhou, part from the sale of his vehicle, and part would be his own money. He did not mention which specific property he was going to purchase but said it would probably be in River Green.
- [74] Mr. Zhou argues that he therefore has an equitable interest in the property and the court should draw an adverse inference that the entire \$240,000 was used to purchase the Richmond property as there is no evidence from Mr. Li otherwise. Mr. Zhou argues that Mr. Li did not produce any documents disproving that the entire \$240,000 was not used to purchase the Richmond property. He says documents, such as bank records, would have been relevant and producible. I agree they would have been relevant records given the pleadings. No evidence was given as to whether there was a request under Rule 7-1(10) or (11) of the Supreme Court Civil Rules, B.C. Reg. 168/2009, for such records to be produced.
- [75] The only evidence regarding a possible use of funds to purchase the Richmond property is Mr. Li's statement to Mr. Zhou that he wanted to purchase a property and to do so he would use funds from several sources including funds from Mr. Zhou. There is no evidence of the amount he intended to use from Mr. Zhou, nor is there evidence that in fact Mr. Li did use money from Mr. Zhou to purchase the Richmond property. The most that can be said is that Mr. Li's statement to Mr. Zhou, as an admission against interest, establishes that he intended

to use some of the funds he received from Mr. Zhou to purchase a property. Mr. Zhou must satisfy a minimum evidentiary burden before an adverse inference may be drawn; otherwise the burden of proof would be reversed. In my view, it would not be appropriate to draw an adverse inference that the entire \$240,000 can be traced to the Richmond property.

[76] Even if I were to find that the evidence established that some funds from the purchase of the shares could be traced to the Richmond property, I do not find this is an appropriate case to order a remedial constructive trust.

[77] Mr. Zhou's counsel argues there is unjust enrichment. The words "unjust enrichment" are not found in the notice of civil claim, but Mr. Zhou's counsel points to paragraphs 13 and 29 where Mr. Zhou pleads vaguely the elements of unjust enrichment. Even if that is a sufficient pleading, the claim fails because all of the elements are not established. To establish unjust enrichment there must be an enrichment to the defendant, a corresponding deprivation to the plaintiff, and no juristic reason for the enrichment and the deprivation: *Moore v. Sweet*, 2018 SCC 52 at para. 37. In this case, there is a juristic reason: there was a contract to purchase the shares.

[78] However, Mr. Zhou has established a fraudulent misrepresentation, and this may form the basis of a claim for remedial constructive trust.

[79] In *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217, the Supreme Court of Canada stated:

43 I conclude that in Canada, under the broad umbrella of good conscience, constructive trusts are recognized both for wrongful acts like fraud and breach of duty of loyalty, as well as to remedy unjust enrichment and corresponding deprivation. While cases often involve both a wrongful act and unjust enrichment, constructive trusts may be imposed on either ground: where there is a wrongful act but no unjust enrichment and corresponding deprivation; or where there is an unconscionable unjust enrichment in the absence of a wrongful act, as in *Pettkus v. Becker*, *supra*. Within these two broad categories, there is room for the law of constructive trust to develop and for greater precision to be attained, as time and experience may dictate.

45 In *Pettkus v. Becker*, *supra*, this Court explored the prerequisites for a constructive trust based on unjust enrichment. This case requires us to explore the prerequisites for a constructive trust based on wrongful conduct. Extrapolating from the cases where courts of equity have imposed constructive trusts for wrongful conduct, and from a discussion of the criteria considered in an essay by Roy Goode, "Property and Unjust Enrichment", in Andrew Burrows, ed., *Essays on the Law of Restitution* (1991), I would identify four conditions which generally should be satisfied:

- (1) The defendant must have been under an equitable obligation, that is, an obligation of the type that courts of equity have enforced, in relation to the activities giving rise to the assets in his hands;
- (2) The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligation to the plaintiff;

- (3) The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties and;
- (4) There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g., the interests of intervening creditors must be protected.
- [80] In *Tracy v. Instalogs Financial Solutions Centres (B.C.) Ltd.*, 2010 BCCA 357, the court reviewed the leading cases on constructive trust, including *Pettkus v. Becker*, [1980] 2 S.C.R. 834, *Peter v. Beblow*, [1993] 1 S.C.R. 980, and *Soulos*. At para. 23 of *Tracy*, the court noted that the majority in *Peter v. Beblow* emphasized that for a constructive trust to arise, the plaintiff had to establish a direct link to the property which is the subject of the trust because of the plaintiff's contribution. The plaintiff also had to establish the insufficiency of a monetary award as equity generally prefers in personam remedies over in rem remedies.
- [81] After noting that *Pettkus* concerned the prerequisites for a constructive trust based on unjust enrichment, and *Soulos* concerned the prerequisites for a constructive trust based on wrongful conduct, and after citing the four criteria in *Soulos* (as set out above), the court in *Tracy* stated:
- [26] (As many commentators have pointed out, the reference to an "equitable obligation" seems to have been intended to encompass more than "fiduciary duty".) Applying these conditions in *Soulos*, the Court confirmed that the defendant broker had been under an equitable obligation in relation to the property at issue; that he had acquired the property in breach of his duty to the plaintiff; that a constructive trust was "required in cases such as this to ensure that agents and others in positions of trust remain faithful to their duty of loyalty"; and that there were no factors that made the imposition of a constructive trust unjust.
- [27] The case at bar is of course one of unjust enrichment. Although arguably it is also one involving a "wrongful act" – i.e., the defendants' contravention of the Criminal Code – it is possible to read *Soulos* as meaning that different criteria should be applied to each category and that the two are distinct. At the same time, the four *Soulos* conditions overlap considerably with the two enunciated in *Peter v. Beblow*. We may assume the broad concept of "equitable obligation" is met by a finding of unjust enrichment; the second *Soulos* requirement that the assets were received by the defendant as a result of "agency activities" may be seen as one type of "direct link" that accords with the second *Peter* requirement; and the third *Soulos* condition may be seen as a broader version of the "insufficiency of damages" requirement in *Peter*. Only the fourth *Soulos* condition, the absence of factors that would make a trust remedy unjust, is missing from the "pre-requisites" specified in the earlier family law cases. The defendants in the case at bar relied on this requirement to argue that the imposition of a constructive trust, which they characterize as an "extraordinary" remedy, would cause significant prejudice to third parties who have been paid by the defendants over the years for goods or services by means of revenues received in the course of the Instalogs business.

- [82] I find that Mr. Zhou has established the first condition in Soulos. A fraudulent misrepresentation may be a breach of an equitable obligation within the meaning of that criteria. However, I find that he has not established the remaining three conditions.
- [83] Mr. Zhou has not established that the funds received by Mr. Li resulted from an agency activity or that there is a substantial and direct link to the Richmond property. The only evidence of a link is Mr. Li's evidence to Mr. Zhou that he intended to use some of the funds with other sources of funds towards the purchase of a property. The Richmond property was not the subject of the share purchase, or in any way related to it. This is unlike the situation in Soulos, where the specific property in issue in that case was the subject of the dealings between the parties, or the situation in Pettkus, where the plaintiff had contributed directly to property. The purchase of the Richmond property was nearly a year later, and there is no evidence of what, if any funds from the share purchase, were used to purchase the property.
- [84] No evidence was led that an in personam remedy would be insufficient. No evidence was given as to whether a judgment against Mr. Li will not be collected. Mr. Zhou had registered a certificate of pending litigation against the property. He argues that if a constructive trust is not granted, and he is granted a judgment only, which he could register against the Richmond property, he will lose priority over any subsequent charges against the property. That may be true, but Mr. Zhou has not asserted a persuasive reason as to why he should be in effect granted the status of a secured creditor over others who may have claims against Mr. Li. Mr. Zhou argues that he had to take the steps of proceeding to trial while other creditors may have not had to do that. That is not a sufficient reason.
- [85] Further, no evidence was led as to how the interests of others who have charges against the Richmond property may be affected by a declaration of a constructive trust. No notice was given to those creditors, nor was any evidence tendered as to the nature of those charges other than what can be gleaned from the State of Title Certificate.
- [86] I find Mr. Zhou has not established a basis for ordering a remedial constructive trust or an equitable tracing. It is therefore not necessary for me to make any declaration regarding the Richmond property. Further, while Mr. Fu has testified regarding his lack of interest in the Richmond property, in my view, it would not be appropriate to make a declaration regarding his interests when considering the lack of specificity in his evidence, and in the absence of notice to the other charge holders on the property, and further information regarding those charges. I therefore decline to do so.

Judgment

- [87] Mr. Zhou will have judgment against Mr. Li for \$240,000 plus interest pursuant to the Court Order Interest Act, R.S.B.C. 1996, c. 79. Mr. Zhou will have costs of this action against Mr. Li at Scale B.

"Norell J."

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