Keeping it in the Family: A Recipe for Trouble for Corporations, a Recipe for Disaster for Expert Witnesses

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By

Closely held corporations do not operate pursuant to a different statute than widely held corporations. Generally speaking, all corporations created pursuant to the same business corporation statute – whether controlled by a sole director, officer and shareholder, a 20-member board of directors or 100 shareholders pursuant to a Unanimous Shareholders' Agreement – have the same governance obligations and responsibilities.

While this may be technically correct, the reality is often quite different. One is not surprised when learning that a closely held corporation is run in a haphazard manner, with little regard to statutory obligations.

Treating a corporation as an extension of one's own bank account is fraught with risk. One main concern is that a court could disregard the corporation's separate legal identity altogether and "pierce the corporate veil", defeating the purpose of incorporating in the first place.

The recent decision of Justice Lacoursière of the Quebec Superior Court in *Cuscuna v Ferrarelli*, 2017 QCCS 2475 demonstrates another hazard of loose management and operational oversight: unnecessarily complicated, arduous and expensive legal proceedings when things go wrong.

The corporation at the centre of the dispute in *Cuscuna* was Garderie St-Michel F.C. Inc. – referred to as "Garderie FC" in the reasons for decision. Garderie FC operated a daycare centre in Montreal. It had two 50% shareholders: Ms. Cuscuna, who helped to run the daycare on a day-to-day basis, and Mr. Ferrarelli, who performed accounting and bookkeeping services for the company. Garderie FC was run like a family business, with many family members working at the daycare over time.

The dispute's history dates back to the late 1980's, but at its core were duelling allegations by the shareholders that the other had taken out more than his or her fair share of money from the business. What one would assume would be a relatively straightforward exercise – determining how much money each shareholder took from the business – turned into a nightmare, capped by a 20-day trial in Quebec Superior Court. Complicating the forensic accounting exercise undertaken by the parties' respective experts was the admitted "loose" operation of the business, and the parties' propensity to simply take money out of the business whenever they felt like doing so.

The trial judge detailed several instances over the years of the shareholders using corporate money for their own purposes. But many of the improper withdrawals were done with the knowledge of both shareholders. The governing rule between the shareholders seemed to be that improper withdrawals were fine, so long as they were equal. Thus, improper payments to a family member were ignored so long as for every improper withdrawal by one shareholder, there was an equal withdrawal for the other shareholder. This almost had a devastating effect on the plaintiff's action, as the trial judge wondered whether, even after finding that the defendant had improperly taken more money out of the corporation than the plaintiff had, to grant relief at all:

> Given the particular facts of this case, where Garderie FC has been run, from day one, with no other guiding principle than that of making sure that the shareholders were generally treated as equally as possible, with little regards for rules, and, in the last years, in an atmosphere of distrust, it is difficult to identify the Plaintiff's reasonable expectation which has been violated; in that sense, it has been tempting for the Court to simply hold that the oppression remedies of [the applicable business corporations act] were simply not open to the Plaintiff.

In the end, however, the trial judge reasoned that he had an obligation to intervene in the dispute on behalf of the plaintiff because her reasonable expectation – to be treated fairly – had indeed been violated by the defendant.

The decision spans over 360 paragraphs and touches on several interesting aspects of corporate law and the oppression remedy. While several of the findings are most applicable in Quebec, one finding regarding expert witnesses is applicable to all commercial litigators in Canada and should serve as a strong caution going forward.

The case was largely a forensic accounting exercise, with both parties retaining an expert to aid in determining their losses. Incredibly, the plaintiff's expert was the father of the plaintiff's lawyer in the case. The trial judge was very critical of this in his reasons for decision, writing, among other things:

> …there is a big cloud on the overall impartiality of [the plaintiff's expert's] opinions. … In these circumstances, the Court is not at all convinced that [he] fulfilled, or could fulfill, his mission objectively and impartially or allowed or, in fact, could allow his mission as an expert to "override the parties' interests". Moreover, the Court wonders whether it was well advised for the Plaintiff's lawyers to suggest to choose [him] to act as an expert and, for the latter, to agree to act.

The familial connection between expert and lawyer affected the expert's credibility. This hurt the plaintiff's case, both because the defendant's expert's evidence was preferred in some instances because of her lack of impartiality, and because the cost award was reduced significantly (the plaintiff's expert's fees alone were over $240,000, but she was awarded only $70,000 total for her expert and legal fees).

Independence of an expert witness is paramount in any action, but as the court found in *Cuscuna*, it is particularly important when the expert is a forensic accountant, since issues of forensic accounting put the court "very much at the mercy of the expert's view".

While it is surprising that this needs to be said, this case shows that it does: counsel should not recommend that his or her client retain one of the counsel's family members as an expert. You risk compromising your client's case, which could lead to a potential negligence claim. Not to mention the embarrassment that can result from a trial judge lambasting your poor lapse in judgment.

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