

Case In Point

Expelling a Partner: An Expensive Cautionary Tale for Partnerships

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In a cautionary tale for partnerships large and small, the Ontario Superior Court has found that BDO Canada LLP (BDO) breached the terms of its Partnership Agreement (Agreement) and its fiduciary duty when it required Tim Ludwig (Ludwig) to retire from the partnership. Damages in excess of \$1.3 million were awarded.

In [Tim Ludwig PC v BDO Canada LLP](#), Ludwig, through his professional corporation, was a partner of the BDO firm in Edmonton. In 2014, Ludwig was advised by two partners of the firm that the CEO was requiring him to retire due to economic issues with the insolvency practice at that firm. He was told the decision was not negotiable. Ludwig transferred his practice to another partner but did not accept that he could be forced to retire in this manner.

BDO then invoked Article 17.4 of the Agreement as grounds for the decision. That Article states:

If the Policy Board unanimously determines that it is not in the best interests of the Partnership for a particular Partner to remain in the Partnership, the Policy Board shall give notice in writing to the affected Partner, requesting such Partner to resign, and shall give notice to that effect to all the Partners and Designated Persons. Upon delivery of such notice by the Policy Board, the affected Partner shall be deemed to have resigned from the Partnership. The affected Partner shall be entitled to receive his/her Entitlement (to the extent applicable) in accordance with Article 11 as though s/he was a retired Partner at the date on which s/he is deemed to have resigned from the Partnership.

A “Policy Board” is comprised of seven members of the partnership.

Ludwig brought an action against BDO, arguing that his forced retirement was a breach of the Agreement. The matter proceeded by way of summary judgment.

The Court confirmed that partners are not employees of their firms; rather their rights are governed by the partnership agreements and the applicable common law. It then referenced the jurisprudence, the *Partnership Act* and authoritative texts on partnership law in Canada in finding that the removal of Ludwig from the partnership breached the Agreement. On the question of damages, the Court raised the issue of mitigation and noted that because of the existence of a non-competition provision in the Agreement, Ludwig, who was 62, was effectively “deprived of an opportunity to make a living in his profession.” It then granted the damages requested by Ludwig, most significantly damages for lost profit allocation from the date of expulsion to the date of his compulsory retirement in January 2019 (approximately \$1.2 million). A retirement benefit (\$61,198) and aggravated damages “reflecting the embarrassment and reputational harm which he experienced” (\$100,000) were also awarded. Ludwig did not seek to dissolve the partnership nor did he request punitive damages.

In making its determination, the Court noted the following legal principles:

- the power of expulsion of a partner from the partnership will be construed strictly as the partner will be deprived of future profits (per *Lindley & Banks on Partnerships*)
- partners are fiduciaries: “the utmost good faith is due from every member of a partnership towards every other member” (per *Lindley & Banks*)
- there is an expectation that any exercise of discretion be done rationally and not arbitrarily
- there is potential for abuse of the power to expel a partner and it is therefore critical that the power be exercised in good faith.

Based on these principles, the Court held that BDO breached the terms of Article 17.4 of the Agreement: a valid determination was not made by the Policy Board as required, but rather the retirement decision had been made by the CEO who, Ludwig was advised, had the “absolute right to demand it.” The Court also noted that the Policy Board did not meet to discuss the issue until three months after Ludwig was advised of the decision.

The Court rejected BDO’s argument that the exercise of the discretion to expel should be based on a subjective standard, as the decision nonetheless “still requires some evidence that would allow the court to inspect the propriety of that decision.” BDO’s assertion that the Edmonton office, and Ludwig, were underperforming was not supported by the evidence. The Court found:

- the Policy Board did not have unfettered discretion under Article 17.4, an assertion made by BDO but one which could not be reconciled with the principle that the discretion be exercised in good faith
- there was no evidence that the Policy Board formed its decision independently; rather, evidence suggested the CEO sought to persuade it of the need for Ludwig’s expulsion
- Ludwig was never given the opportunity to present his position to the Policy Board nor did he receive advance notice that the Policy Board was meeting to discuss his case; in the absence of cause, “the expellee should have the opportunity of stating his case to the other person wielding the power of expulsion”
- there was no evidence that relevant inquiries were undertaken by BDO regarding Ludwig’s alleged underperformance or regarding the determination “to expel [in accordance with] the strict standards expected in this area of partnership law”
- while the Policy Board had the authority to expel a partner without cause, it could only do so where it could demonstrate the action was in the best interests of the partnership, it had reasonable grounds to act and it acted in “utmost good faith,” which was not demonstrated in this case.

The Court granted Ludwig’s claim. In awarding the damages noted above, it found that the combined effect of a non-competition clause and the “compulsory resignation” meant that Ludwig’s professional career “was effectively over.”

The case serves as an important reminder that an expulsion of a partner from a partnership will be construed strictly by a court. The terms of the applicable partnership agreement must be judiciously followed and any decisions to expel without cause must be based on reasonable grounds and in good faith. Moreover, the partner to be expelled should be afforded an opportunity to be heard by the decision maker(s), who should entertain that partner’s submission with an open mind. This last point is critical, as the Court above noted that affording a right to be heard, even where not strictly required, “is an indication of good faith on the part of the expelling partners and might cure an otherwise defective procedure.”