Case In Point

Expulsion of Partners: Ontario Court of Appeal Confirms Good Faith Requirement

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In Tim Ludwig Professional Corporation v. BDO Canada LLP, the Ontario Court of Appeal recently upheld a lower court decision which awarded an expelled partner in excess of $1.3 million in damages for lost profits and benefits, and aggravated damages (see our *Case in Point*, Expelling a Partner: An Expensive Cautionary Tale for Partnerships). In doing so, the Court confirmed the good faith requirement to expel partners from a partnership and the stringent standards that courts will apply to the interpretation of partnership agreements and partner expulsions.

At issue before the Court of Appeal was whether BDO breached the provision of its partnership agreement, which stated:

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.

In affirming the lower court's determination that BDO had breached the agreement, the Court of Appeal reinforced the underlying common law principle that partners owe each other a duty of utmost good faith, and that partnership agreements must be interpreted in light of this standard.

While the Court of Appeal noted that the partnership agreement provision in question was to be interpreted with regard to its purpose of providing a lower standard for expulsion than a provision setting out specific grounds for termination (e.g. a criminal offence), BDO's Policy Board had an obligation to provide evidence that its decision was "reasonably referable to the best interest requirement" as set out in the provision, and as required at common law.

The Court of Appeal agreed with the lower court's determination that BDO made "bald assertions" of underperformance, and that the decision to expel the partner was not in fact made by the Policy Board, but rather the CEO.

The Court of Appeal also considered the lower court's $100,000 aggravated damages award. While noting that caution must be exercised when directly applying the rules governing "intangible damages" from the employment context, the Court of Appeal applied the reasoning in *Honda Canada Inc. v. Keays* together with the principles of partnership law, in upholding the lower court's $100,000 aggravated damages award. The Court of Appeal also confirmed the possibility of extraordinary damages for intangible harm in the partnership context, where the harm was in the reasonable contemplation of the parties when they made their contract.

Finally, the Court of Appeal upheld the lower court's award of expectation damages, based on profits that the partner would have received had the partnership agreement not been violated.

In summary, the Court of Appeal has confirmed the stringent application of the good faith standard that is to be applied to the exercise of partnership agreement provisions. The expulsion of a partner requires a partnership to strictly adhere to the good faith requirement and its own partnership terms, and partners should be afforded a right to be heard before expulsion. Failure to properly carry out a partner expulsion can result in significant financial exposure to a partnership, and under certain circumstances, extraordinary damages.