Midland Resources Holding Limited et al. v. Shtaif et al. Shtaif et al. v. Midland Resources Holding Limited et al.

[Indexed as: Midland Resources Holding Ltd. v. Shtaif]

Ontario Reports

Court of Appeal for Ontario,

Doherty, D.M. Brown and L.B. Roberts JJ.A.

April 20, 2017

135 O.R. (3d) 481 | 2017 ONCA 320

Case Summary

Actions — Bars — Settlement — Plaintiff shareholders induced by defendants' deceit and fraudulent misrepresentation to invest in sham company to develop oil and gas fields in Russia — Fraud coming to light in June 2006 — Parties entering into settlement agreement and reorganizing venture using new company — Plaintiffs suing defendants for fraudulent misrepresentation, deceit and conspiracy — Settlement agreement not precluding plaintiffs from asserting any claims for period before June 2006.

Corporations — Directors — Duties — Trial judge erring in finding that director was liable to shareholder for breach of director's fiduciary duties to company.

Corporations — Shareholders — Plaintiff shareholders induced by defendants' deceit and fraudulent misrepresentation to invest in sham company to develop oil and gas fields in Russia — Plaintiff's claims against defendants for fraudulent misrepresentation and conspiracy not precluded by rule in Foss v. Harbottle — Plaintiffs suing in their own capacity as investors rather than as shareholders of sham company.

Torts — Fraudulent misrepresentation — Director of company liable for fraudulent misrepresentation based on his failure to disclose material facts at board meeting.

The plaintiffs AS and ES invested money in a corporation, Magellan, for the purpose of developing oil and gas fields in Russia. They advanced the funds through the plaintiff Midland Ltd. The venture was initiated by the defendant MS, an oil executive. Before the plaintiffs became involved, MS met IB, who was using a false name to hide his criminal past and represented himself to be a wealthy Toronto businessman. IB was the principal of BDW, a sham company. IB falsely represented to MS that BDW wanted to invest $70 million in MS's oil field venture, and offered Magellan as the corporate vehicle for that venture, representing it as a Delaware public company trading on the Pink Sheets. In fact, Magellan was fraudulently created by IB specifically for MS's venture. IB intended to target MS's investors and use their participation in Magellan to lend it credibility, and to then unlawfully issue free trading shares at artificially inflated prices. There were many red flags that should have led MS to be wary of IB.

The defendant EB, an investment advisor, arranged a meeting between AS, MS and himself. EB confirmed to AS that BDW was a sophisticated Bay Street investor. The plaintiffs agreed to invest $50 million in the proposed venture on the understanding that BDW had committed to investing $70 million. EB received a commission as a result. MS was aware that the $70 million would not be forthcoming. The defendant GR agreed to be BDW's representative on Magellan's board. At the first Magellan board meeting in January 2006, GR failed to disclose to the plaintiffs what he then knew: that IB was using a pseudonym to hide his [page482] criminal past, that BDW and Magellan were Pink Sheet companies that would not attract Canadian institutional interests, and that he had already received two million shares from IB without board approval. By June 2006, it had become apparent that Magellan was a sham company promoted by fraudsters. In order to keep the venture going, Midland Ltd. and Magellan entered into a settlement agreement which provided that the venture would be reorganized under a legitimate company, K Ltd. By mid-2007, the plaintiffs and the defendants had lost trust in each other. The plaintiffs sued and the defendants counterclaimed. The trial judge found for the plaintiffs and dismissed the counterclaims. The defendants appealed the judgment for the plaintiffs, and GR appealed the dismissal of his counterclaim.

Held, the appeal from judgment for the plaintiffs should be allowed in part; the appeal from the dismissal of the counterclaim should be dismissed.

The rule in *Foss v. Harbottle* did not preclude the plaintiffs from asserting their claims without seeking leave to commence a derivative action. The defendants had not specifically pleaded a *Foss v. Harbottle* defence, and had they done so it would have undercut the foundation for their own counterclaims. In any event, the plaintiffs were suing as investors and not as shareholders of Magellan. The rule in *Foss v. Harbottle* does not preclude a shareholder from maintaining a claim for harm done directly to it.

The defendants did not plead that the June 2006 settlement agreement operated to release the pre-June 2008 claims, nor did they raise the defence at trial. On that ground alone, it was not now open to them to assert the defence as a ground for setting aside the judgment. In any event, the personal plaintiffs were not parties to the settlement agreement and it contained no terms for their benefit, Midland Ltd. gave no release of claims in the agreement, and the agreement contained no provision purporting to release the defendants from claims unknown to the plaintiffs at the time the agreement was made.

The trial judge did not err in finding IB liable for fraudulent misrepresentation.

GR breached his fiduciary duties as a director by failing to disclose material information to the Magellan board at the first board meeting. However, the trial judge erred in awarding damages to Midland Ltd. for that breach. Midland Ltd. did not, as a shareholder, enjoy a cause of action against GR for his breach of fiduciary duty to Magellan. However, Midland could recover against GR for fraudulent misrepresentation. A misrepresentation can involve not only an overt statement of fact, but also certain kinds of silence. GR knew that the information he possessed about IB's criminal past and name change was material, and he intended the plaintiffs to rely on the favourable impression about BDW created by his silence. The plaintiffs acted to their

detriment in relying on GR's non-disclosure. Had the information been disclosed to the Magellan board, the board would not have proceeded with Magellan. Midland Ltd. suffered a direct loss as a result.

The trial judge did not err in finding MS liable to Midland Ltd. for deceit and unlawful conspiracy in respect of conduct that took place before June 21, 2006. She erred in finding MS liable to Midland Ltd. for his breach of fiduciary duty to Magellan, as Midland Ltd. was not the beneficiary of the duty and could not recover for its breach. However, that error had no effect on the judgment against MS for his pre-June 2006 conduct, given the trial judge's findings against him of deceit.

The trial judge erred in finding liability against MS and GR based on post-June 2006 conduct.

The trial judge did not err in dismissing GR's counterclaim. [page483]

Cases referred to

484887 Alberta Inc. v. Faraci, [2002] A.J. No. 522, 2002 ABQB 406, [2002] 8 W.W.R. 748, 4 Alta. L.R. (4th) 154, 311 A.R. 355, 27 B.L.R. (3d) 110, 113 A.C.W.S. (3d) 252; *Amertek Inc. v. Canadian Commercial Corp.* (2005), 76 O.R. (3d) 241, [2005] O.J. No. 2789, 256 D.L.R. (4th) 287, 200 O.A.C. 38, 5 B.L.R. (4th) 199, 31 C.C.L.T. (3d) 238, 141 A.C.W.S. (3d) 226 (C.A.) [Leave to appeal to S.C.C. refused [2005] S.C.C.A. No. 439]; *BCE Inc. v. 1976 Debentureholders*, [2008] 3 S.C.R. 560, [2008] S.C.J. No. 37, 2008 SCC 69, 52 B.L.R. (4th) 1, EYB 2008-151755, J.E. 2009-43, 301 D.L.R. (4th) 80, 71 C.P.R. (4th) 303, 383 N.R. 119, 172 A.C.W.S. (3d) 915; *Concord Kitchens GP Inc. v. Eastern Construction Co*., [2010] O.J. No. 1597, 2010 ONSC 2168, 187 A.C.W.S. (3d) 340 (S.C.J.); *Demagogue Pty. Ltd. v. Ramensky* (1992), 39 F.C.R. 31, 110 A.L.R. 608 (Aus. F.C.); *Fiorillo v. Krispy Kreme Doughnuts, Inc*. (2009), 98 O.R. (3d) 103, [2009] O.J. No. 2430, 60 B.L.R. (4th) 113 (S.C.J.); *Foss v. Harbottle* (1843), 67 E.R. 189, 2 Hare 461; *Goldex Mines Ltd. v. Revill* (1974), 7 O.R. (2d) 216, [1974] O.J. No. 2245, 54 D.L.R. (3d) 672 (C.A.); *Groupe d'action d'investisseurs dans Biosyntech v. Tsang*, [2016] Q.J. No. 17247, 2016 QCCA 1923, 2016EXP-3850, J.E. 2016-2152, EYB 2016-273408; *Guarantee Co. of North America v. Gordon Capital Corp*., [1999] 3 S.C.R. 423, [1999] S.C.J. No. 60, 178 D.L.R. (4th) 1, 247 N.R. 97, 126 O.A.C. 1, 49 B.L.R. (2d) 68, 15 C.C.L.I. (3d) 1, 39 C.P.C. (4th) 100, [2000] I.L.R. I-3741, 91 A.C.W.S. (3d) 796; *Hamilton v. 1214125 Ontario Ltd*., [2009] O.J. No. 3958, 2009 ONCA 684, 83 C.L.R. (3d) 157, 84 R.P.R. (4th) 25; *Harris v. Leikin Group Inc*. (2014), 120 O.R. (3d) 508, [2014] O.J. No. 2914, 2014 ONCA 479, 374 D.L.R. (4th) 452, 321 O.A.C. 181, 29 B.L.R. (5th) 1, 98 E.T.R. (3d) 81, 241 A.C.W.S. (3d) 120, affg [2013] O.J. No. 1097, 2013 ONSC 1525, 85 E.T.R. (3d) 1 (S.C.J.); *Hav-A-Kar Leasing Ltd. v. Vekselshtein*, [2012] O.J. No. 5592, 2012 ONCA 826; *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, [1997] S.C.J. No. 51, 146 D.L.R. (4th) 577, 211 N.R. 352, [1997] 8 W.W.R. 80, J.E. 97-1151, 115 Man. R. (2d) 241, 31 B.L.R. (2d) 147, 35 C.C.L.T. (2d) 115, 71 A.C.W.S. (3d) 169; *Huber v. Way*, [2014] O.J. No. 3498, 2014 ONSC 4426 (S.C.J.); *Jackson v. Trimac Ltd*., [1994] A.J. No. 445, [1994] 8 W.W.R. 237, 1994 ABCA 199, 20 Alta. L.R. (3d) 117, 155 A.R. 42, 49 A.C.W.S. (3d) 886; *Kaiman v. Graham*, [2009] O.J. No. 324, 2009 ONCA 77, 45 E.T.R. (3d) 163, 245 O.A.C. 130, 75 R.P.R. (4th) 157; *Meditrust Healthcare Inc. v. Shoppers*

Drug Mart, a Division of Imasco Retail Inc. (2002), 61 O.R. (3d) 786, [2002] O.J. No. 3891, 220 D.L.R. (4th) 611, 165 O.A.C. 147, 28 B.L.R. (3d) 163, 117 A.C.W.S. (3d) 713 (C.A.); *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, [2004] S.C.J. No. 64, 2004 SCC 68, 244 D.L.R. (4th) 564, 326 N.R. 267, J.E. 2004-2016, 49 B.L.R. (3d) 165, 4 C.B.R. (5th) 215, REJB 2004-72160, 134 A.C.W.S. (3d) 548; *Reliable Life Insurance Co. v. M.H. Ingle & Associates Insurance Brokers Ltd.* (2002), 59 O.R. (3d) 1, [2002] O.J. No. 1382, 158 O.A.C. 128, 38 C.C.L.I. (3d) 1, [2002] I.L.R. I-4073, 113 A.C.W.S. (3d) 332 (C.A.); *Strong v. Pacquet Estate* (2000), 50 O.R. (3d) 70, [2000] O.J. No. 2792, 135 O.A.C. 161, 2 C.C.E.L. (3d) 8, 98 A.C.W.S. (3d) 833 (C.A.) [Leave to appeal to S.C.C. refused [2000] S.C.C.A. No. 532]

Statutes referred to

Securities Act, R.S.O. 1990, c. S.5, s. 126.1 [as am.]

Rules and regulations referred to

Rules of Civil Procedure, R.R.O. 1990, Reg. 194, rules 25.06(8), 25.07(4)

Authorities referred to

McGuinness, Kevin P., *Canadian Business Corporations Law*, 2nd ed. (Markham, Ont.: LexisNexis, 2007) [page484]

Van Kessel, Robert, and Paul Rand, *The Law of Fraud in Canada* (Toronto: LexisNexis, 2013)

Waddams, S.M., *The Law of Contracts*, 6th ed. (Aurora, Ont.: Canada Law Book Inc., 2010)

APPEAL from the judgment of Sanderson J., [2014] O.J. No. 1013, 2014 ONSC 997 (S.C.J.) allowing the claim and dismissing the counterclaim.

Kevin L. MacDonald and *Jamie M. Sanderson*, for appellants Michael Shtaif and Eugene Bokserman.

Gregory Roberts, in person.

Symon Zucker, *Kenneth Prehogan* and *Kim A. Mullin*, for respondents Midland Resources Holding Limited, Alex Shnaider and Eduard Shyfrin.

The judgment of the court was delivered by
D.M. BROWN J.A.: —

I. *Overview*

[1] In 2006 and 2007, the parties to these appeals were shareholders in two successive corporate ventures to develop small oil and gas fields in Russia. During the first half of 2006, they carried on the venture through Magellan Energy Limited ("Magellan"). By June 2006, it became apparent Magellan was not the legitimate public company some of the shareholders had thought it was; in fact, it was a sham public corporation promoted by two of the defendants, Irwin Boock (a.k.a. Irwin Krakowsky or John Howard) and Stanton De Freitas.

[2] The shareholders thereupon reorganized their venture using a new company, Koll Resources Limited ("Koll"), to continue it.

[3] The shareholders fell into two groups. The first consisted of the respondents, Alex Shnaider, Eduard Shyfrin and their company, Midland Resources Holding Limited ("Midland"). They put up all the funds for the venture -- ultimately some US$50 million. Initially, Shnaider and Shyfrin advanced funds through Midland; later, they personally invested in Koll.

[4] Two of the appellants, Michael Shtaif and Gregory Roberts, formed part of the second group of shareholders. Roberts put up no money for the venture; Shtaif, through his operating company, Euro Gas Consulting Inc., covered just over $1 million of the venture's operating expenses. The third appellant, Eugene Bokserman, was not a shareholder, but an investment advisor who was involved in arranging Midland's investment in Magellan. [page485]

[5] By mid-2007, each group of shareholders had lost trust in the other. Competing lawsuits ensued, in which the parties alleged myriad acts of malfeasance against each other. The various actions were consolidated into this proceeding.

[6] Shnaider, Shyfrin and Midland were the plaintiffs in the consolidated action. Their central claim was that the defendants, including the appellants, duped them into investing in a project they knew was fraudulent from the start, and then induced them to throw good money after bad by investing in Koll in an attempt to recoup their losses.

[7] The defendants counterclaimed that the plaintiffs were the real fraudsters because they took control of the project after the Koll reorganization had failed, depriving the defendants of their interest in what they maintain was a potentially lucrative business.

[8] Following a 53-day trial, the trial judge released a 166-page decision. Shnaider, Shyfrin and Midland were completely successful. The trial judge accepted their evidence that they were induced by the defendants' deceit to invest millions of dollars in a sham corporation. Once that fraud was revealed, the defendants led the plaintiffs to believe that they, too, had been duped. The trial judge found that the defendants persuaded the plaintiffs to stick with the project on new and deliberately misleading terms, causing them further losses.

[9] In the end, the trial judge awarded the respondents the full measure of compensatory damages they sought from the appellants: US$1.5 million from Bokserman, US$8,270,000 from Boock and US$59,559,512.97 from Shtaif and Roberts. She dismissed the counterclaims of Shtaif and Roberts.

[10] Three of the defendants, Shtaif, Bokserman and Roberts, appeal the judgment against them. Roberts also appeals the dismissal of his counterclaim.

[11] The appellants raise four principal objections to the judgment, some of which are raised for the first time on appeal.

[12] First, they submit that the respondents' claim is precluded by the rule in *Foss v. Harbottle* (1843), 67 E.R. 189, 2 Hare 461, which holds that individual shareholders (such as Shnaider, Shyfrin and Midland) have no cause of action for wrongs done to a corporation (the sham company Magellan and its legitimate successor, Koll).

[13] Second, they claim a June 21, 2006 settlement agreement precludes the respondents from asserting any claims for the period before that date.

[14] Third, they submit the trial judge erred in finding them liable for deceit, unlawful act conspiracy and breach of fiduciary [page486] duty. Some of her findings of fact they contend were not available to her on the evidence; others were made in respect of claims never pleaded.

[15] Fourth, Roberts appeals the dismissal of his counterclaim, arguing the trial judge made numerous factual errors.

[16] For the reasons that follow, I would reject the appellants' first two arguments based on the rule in *Foss v. Harbottle* and the effect of the settlement agreement. I see no error in the trial judge's finding of liability against Bokserman. Nor would I disturb her judgment against Shtaif and Roberts for US$8.27 million for their pre-June 21, 2006 conduct. I would set aside the balance of the judgment against them for post-June 21, 2006 conduct, save for their liability for wrongfully garnishing certain remnant Magellan accounts. Finally, I would dismiss Roberts' appeal in respect of his counterclaim.

II. *Facts Relevant to these Appeals*

[17] In her reasons, the trial judge exhaustively reviewed the evidence and made clear factual findings. This summary of the evidence will focus only on those facts necessary to decide the appeals.

A. *The events of 2005*

The genesis of the venture

[18] Michael Shtaif was an accountant and an oil executive with 15 years' experience in the oil and gas industry. In 2005, he decided to start his own oil production company, which he called Euro Gas. He planned to acquire undervalued Russian oil and gas companies, consolidate them into one company, and take it public on the TSX. He began seeking investors and reviewing potential acquisitions.

[19] As part of his start-up efforts, Shtaif made a commission agreement with Eugene Bokserman. Bokserman was an investment advisor who had known Shtaif for many years. Through the commission agreement, Bokserman agreed to help Shtaif find investors for his new business venture.

October: Shtaif meets Boock/Krakowsky/Howard

[20] In the fall of 2005, a friend of a friend introduced Shtaif via e-mail to a potential investor who said his name was John Howard. "Howard" gave off the appearance of being a wealthy Toronto businessman. He held himself out as the principal of a public company incorporated in the U.S. called BDW Holdings Ltd. (later renamed International/ILGY). [page487]

[21] Unbeknownst to Shtaif at that time, "John Howard" was an alias for Irwin Boock, itself an alias for Irwin Krakowsky. Krakowsky had been convicted of securities fraud and market manipulation and served time in prison for several frauds, which included placing a fraudulent mortgage on his parents' home. The U.S. Securities and Exchange Commission had imposed a trading ban on him. While in prison, Krakowsky married and took his wife's last name, Boock. He also used the aliases David Watson and John Sparrow.

[22] The appellant, Gregory Roberts -- a sometime businessman and lawyer -- had known and acted for Boock/Krakowsky/ Howard for a number of years prior to the events in this proceeding. In 2005, Boock also retained Roberts to change his name to Howard, although Roberts testified that he did not complete this request, having left the practise of law at the time.

[23] In a series of e-mails, Shtaif and "Howard" discussed the possibility of having BDW invest in Shtaif's venture. BDW was listed on the Pink Sheets in the U.S., meaning it did not meet the reporting requirements to be listed as a public company on a major exchange. "Howard" said that BDW was interested in pursuing oil and gas projects.

[24] The trial judge agreed with the respondents that there were red flags that should have led Shtaif to be wary of "Howard":

- within days of their online introduction and before they had met in person, "Howard" suggested Shtaif
- become the president or executive vice-president of BDW, "simply run the show", and receive six million free trading shares, six million restricted shares and six million options in BDW at a penny. Shtaif admitted on cross-examination he had found this "suspicious";

- in their initial e-mail exchanges, "Howard" e-mailed Shtaif using an e-mail address for "David Watson". Even
- though the e-mails to Shtaif came from "Watson's" e-mail, it appears that Shtaif knew he was dealing with "Howard";

- when Shtaif asked to see BDW's most recent financial report, "Howard" sent him an unaudited balance
- sheet showing it had just over US$8 million in assets. "Howard" didn't provide information about the source of the money other than to say was raised by private placement. Shtaif agreed in cross-examination that he wanted to know if BDW was "legit". [page488]

November--early December: Magellan becomes the corporate vehicle for Shtaif's business

[25] In November 2005, still before the two had met in person, "Howard" offered Magellan as the corporate vehicle for Shtaif's oil field venture. "Howard" represented Magellan was a Delaware public company trading on the Pink Sheets. Shtaif agreed, and BDW issued him 12 million shares.

[26] The trial judge found Boock, as "Howard", fraudulently created Magellan in early November 2005 specifically for Shtaif's venture. Magellan was not a legitimate public company. The trial judge held Boock intended to target Shtaif's investors and use their participation in Magellan to lend it credibility. Boock then planned to unlawfully issue free trading shares at artificially inflated prices.

[27] Boock's initial accomplice in this scheme was a Toronto businessman, the defendant Stanton De Freitas. Both Boock and De Freitas later were convicted by the U.S. Securities and Exchange Commission for corporate hijacking -- a practice under which a person usurps the name and securities ticker number of a defunct or inactive publicly traded corporation for use by a newly incorporated company -- and making unregistered offers and sales of the shares of the newly incorporated companies on the Pink Sheets. The Ontario Securities Commission has banned Boock and De Freitas from trading in securities, acquiring securities, or acting as directors or officers of any issuer.

[28] Although De Freitas denied participating in hijacking Magellan, he admitted that he participated in hijacking BDW. He knew that BDW was a sham company and he knew that Boock was falsely representing to Shtaif that BDW had the money to invest in Magellan.

[29] The trial judge concluded Boock and De Freitas were liable for unlawful conspiracy during this time period. Their conduct violated the prohibitions against fraud and market manipulation under the *Securities Act*, R.S.O. 1990, c. S.5, s. 126.1. They made promises about Magellan and BDW to induce potential investors that they knew would never be fulfilled. Their actions laid the foundation for the fraud later perpetrated on the plaintiffs. The trial judge was not prepared to conclude that Shtaif was involved in the initial planning of the unlawful conspiracy. These findings are not at issue on these appeals.

December: "Howard" agrees to invest $70 million, and the respondents enter the picture

[30] Boock/Krakowsky/Howard and Shtaif met in person for the first time on December 6, 2005. De Freitas was present. He [page489] introduced Boock to Shtaif as "John Howard". De Freitas admitted he knew "John Howard" was an alias, and he suspected Boock was trying to get around the U.S. Securities and Exchange Commission trading ban by calling himself Howard.

[31] At the December 6 meeting, "Howard" and De Freitas told Shtaif that BDW would invest $70 million in Magellan. Two days later, "Howard" sent Shtaif a letter of intent stating BDW would pay Magellan $8 million on closing.

[32] Meanwhile, Shtaif's agent, Bokserman, set out to land another investor for Shtaif's venture -- Midland.

[33] Midland is incorporated in Guernsey, the Channel Islands. It operates worldwide in more than 50 countries, with interests in steel, real estate and shipping, among other businesses. As of late 2005, Midland had no experience in the oil and gas industry.

[34] Midland is jointly owned 50/50 by its co-founders, Shnaider (who lives in Toronto and is a Canadian citizen) and Shyfrin (who lives in the United Kingdom and is a Russian citizen). At the time these events unfolded, Shnaider was in his mid-30s and already was one of the wealthiest people in Canada, with a net worth of over $1 billion. Shyfrin also was very wealthy.

[35] Bokserman and Shnaider had known each other since high school and were good friends. In 2005, Bokersman was Shnaider's investment broker; Shnaider occasionally made small investments based on Bokserman's advice.

[36] Bokserman arranged a meeting of Shnaider, Shtaif and himself to discuss Shtaif's new business. Shtaif explained he had identified several undervalued Russian oil and gas properties

and had a corporate vehicle, Magellan, to acquire them. Shtaif said he was looking to raise $120 million and that BDW, a "sophisticated Bay Street investor", already had committed to invest $70 million. Shnaider said he would consider investing $50 million, but would need to consult with his partner Shyfrin.

[37] Shnaider testified Bokserman confirmed to Shnaider everything Shtaif had said, including that BDW was a sophisticated Bay Street investor and Bokserman had met the BDW investors with Shtaif. Bokserman denied doing so. The trial judge accepted Shnaider's testimony. Shnaider testified he took comfort in the fact BDW was committed to investing $70 million in Magellan, demonstrating that someone else believed in Shtaif.

[38] Shtaif, Shnaider and Shyfrin met together for the first time in Moscow on December 11, 2005. Shtaif told them BDW definitely was going to invest $70 million and BDW was a reputable international investor backed by financier, "John Howard". Shtaif told them they had to act fast, as other investors were [page490] lining up. He also told them that once the undervalued properties were consolidated and taken public, the profits would be enormous.

The trial judge's findings regarding the events of 2005

[39] The trial judge accepted the evidence of Shnaider and Shyfrin that they would not have agreed to invest $50 million in the proposed venture without BDW's commitment of $70 million. They were both of the view that $50 million was insufficient to create even a medium-sized oil company. With a total investment of $120 million, they thought the venture could succeed.

[40] The trial judge found Shtaif and Bokserman were both liable for fraudulent misrepresentation during this time period.

[41] The trial judge found Bokserman knew BDW was not a "sophisticated Bay Street investor", as Shtaif had represented it to be. As well, he knew investment bankers and banks were wary of companies, such as BDW, that traded on the Pink Sheets. She found Bokserman intended to deceive the plaintiffs into investing because he wanted to make his commission. She assessed Midland's damages against Bokserman at US$1.5 million, the amount of the commission he ended up receiving from Magellan's funds in April 2006.

[42] The trial judge found that Shtaif (i) knew the representation that BDW would invest $70 million in the project was false based on the red flags preceding "Howard's" offer; (ii) knew that BDW, at most, had around $8 million; (iii) intended to convince Shnaider and Shyfrin that BDW was wealthier and better funded than he knew it to be to induce them to invest $50 million in Magellan; and (iv) knew the respondents would rely on his false misrepresentations.

[43] On December 20, 2005, Shtaif sent Shnaider an "engagement letter" on Magellan letterhead stating that BDW already had transferred $8 million to Magellan. At trial, Shtaif admitted he had received no confirmation from "Howard" that the money had been transferred, and he knew by December 27, 2005 at the latest that BDW had not paid anything. On that date, Boock, using the name "Watson", sent a letter stating that BDW was prepared to transfer the "first portion" of its funding to Magellan, in the amount of $2 million.

[44] The trial judge accepted Shnaider's evidence that Midland decided to invest $50 million in Magellan based on Shtaif's representation that BDW had already paid $8 million.

[45] The trial judge found that after December 27, 2005, Shtaif could not credibly maintain that "Howard" had duped him about BDW having paid anything to Magellan. Once he knew [page491] that Magellan had not transferred the promised $8 million, Shtaif had a positive obligation to inform the respondents the money had not been transferred, as he had earlier represented. The trial judge found that his failure to do so was deceitful.

B. *January 2006: The respondents make their investment, the Magellan board is appointed and the appellant Roberts comes on the scene*

[46] In January 2006, Shnaider e-mailed Shtaif, confirming Midland would invest $50 million in Magellan on two conditions: first, it would receive 40 per cent of the Magellan shares; and second, $120 million in total had been raised. Again, Shtaif let Shnaider believe that BDW already had paid $8 million, with the balance of its $70 million on the way.

[47] The trial judge found Shtaif knew Midland did not want to be the only investor because Shnaider and Shyfrin thought $50 million would not be sufficient capital to create an oil company. Shtaif knew they would be interested only if there was another investor willing to invest $70 million; he presented BDW as that investor. The trial judge found Shtaif (i) used Magellan's purported public company status and BDW's promises to pay a total of $70 million to induce Midland to invest, knowing BDW was not what it was representing itself to be; (ii) knew Magellan then would secure $50 million in funding regardless of whether BDW paid; and (iii) had no honest belief BDW would pay the $70 million.

[48] On January 9, 2006, before the Magellan board met for the first time, "Howard" transferred eight million Magellan shares to himself and 12 million Magellan shares to Shtaif. The trial judge found Shtaif intended to profit from the free-share trading scheme and knew the Magellan share price was being manipulated.

[49] Around the same time, "Howard" called his business friend and former lawyer, Roberts, and asked him to be BDW's representative on Magellan's board. "Howard" gave Roberts two million Magellan shares out of the eight million he had transferred to himself. Roberts paid nothing for those shares. "Howard" also promised Roberts a US$80,000 annual salary from Magellan.

[50] "Howard" appointed De Freitas to be the other BDW representative on the Magellan board. "Howard" gave him three million of his unauthorized shares in Magellan. Midland appointed Shnaider and Shyfrin as its representatives to the board. Magellan's executives, Groag (chairman) and Shtaif (CEO and executive director), rounded out the board. [page492]

[51] The first Magellan board meeting took place on January 20, 2006 in Moscow. The trial judge found that by this point Shtaif had joined in Boock's and De Freitas's unlawful conspiracy to defraud Midland, though with different motives and for different ends. Boock and De Freitas targeted Midland in part to lend legitimacy to Magellan and to make it easier to pump the value of the shares it was intending to unlawfully issue and sell. Shtaif targeted Midland because he wanted its $50 million to build his venture, even though he knew Midland's participation was premised on BDW's sham commitment of $70 million.

[52] The trial judge found the evidence was insufficient to conclude that Roberts was in on the unlawful conspiracy at that point.

C. *February 2006: Magellan commits to buying SibinTek and Reef, and Roberts breaches his fiduciary duties*

[53] Magellan's second board meeting took place on February 19, 2006 in Moscow. At that meeting, the board approved the purchase of two oil fields, SibinTek and Reef. As will be described below, the SibinTek acquisition did not close. By reason of Shtaif's conduct, Magellan lost much of the money Midland advanced for that transaction. The Reef acquisition closed in mid-July. However, Koll eventually sold the Reef asset in 2010 at a significant loss.

[54] This was Roberts' first board meeting as a director. The trial judge found Roberts failed to inform Shnaider and Shyfrin what he knew at the time: (i) "Howard" was really Boock and was using a pseudonym to hide his criminal past; (ii) BDW and Magellan were Pink Sheet companies that would not attract Canadian institutional investors; and (iii) he had already received two million shares in Magellan from "Howard" without board approval.

[55] At trial, Roberts explained he did not disclose any of this information because he believed it was privileged. The trial judge rejected this explanation. She found that if the information could not be disclosed because it was privileged, given its materiality Roberts should not have agreed to join the board. She accepted Shnaider's evidence that had Roberts disclosed the information, he would have realized that Magellan was a "pump and dump" stock scheme and would have declined to participate.[1] [page493]

[56] The trial judge concluded Roberts breached his fiduciary duty to Magellan by failing to disclose what he knew about Boock and BDW. She held, without elaboration, that while Roberts' fiduciary duty was to Magellan, "on the unusual facts here", his breaches caused Midland damages of US$8.27 million -- the portion of the US$50 million Midland had invested in Magellan before the BDW scam was uncovered.

D. *April 2006: Midland pays its $50 million*

[57] On March 31, 2006, Groag sent an e-mail at Shtaif's direction informing the respondents BDW had met its obligation to fund.

[58] The next day, Roberts e-mailed the respondents, Shtaif and Groag to advise he had "canvassed" three investment banks, all of whom who were interested in financing Magellan to the tune of $200--300 million. He said they would need to develop a business plan as a next step. The trial judge found "Howard" asked Roberts to send this e-mail. She found that, contrary to Roberts' representations in the April 1 e-mail, he had not formally approached any investment bank, and none had expressed interest in Magellan.

[59] The trial judge accepted the respondents' evidence that Groag's March 31 representation that BDW had met its obligation to pay was "crucial" to their decision to advance the $50 million. The trial judge found that Boock, De Freitas and Shtaif engaged in an unlawful conspiracy during this period to induce Midland to pay its $50 million subscription to Magellan.

[60] The trial judge further found that Boock and Shtaif were liable for deceit for the statements they made to the respondents during this time. Throughout March 2006, they were

pressing Midland to advance its money even though BDW had not yet advanced any funds. They did so, in part, by suggesting an unnamed third party was prepared to buy Magellan's shares at a higher price than Midland. The unnamed third party was BDW. "Howard" and Shtaif knew BDW's higher offer was a bogus one and was specifically intended to induce Midland to put up its US$50 million. The trial judge also found "Howard", De Freitas and Shtaif were manipulating the share price of Magellan to induce Midland to invest.

[61] Although Roberts and Groag were "also involved", the trial judge was not satisfied on the evidence that they knew exactly what was being planned and therefore could not be said to have been part of the unlawful conspiracy at that time. She noted that congratulatory e-mails sent when Midland finally advanced its US$50 million -- stating, "we're in business" [page494] and "good job" -- were passed only amongst "Howard", Shtaif and De Freitas.

[62] The trial judge also was not satisfied Roberts and Groag were liable for deceit during this time. Groag did not know BDW's offer to pay more than Midland for Magellan's shares was false or that BDW had not actually met its obligation to fund. While Roberts knew the contents of his April 1, 2006 e-mail about the investment banks' interest was misleading, the trial judge held it did not amount to fraudulent misrepresentation.

E. *April 5--May 16, 2006: BDW stalls on meeting its commitment, and Shtaif moves forward with the SibinTek and Reef acquisitions*

[63] On April 5, 2006, Shnaider e-mailed Shtaif seeking confirmation Midland's $50 million had been deposited into Magellan's bank account. Shtaif advised it had and there was currently "over $60 million in the bank". Shtaif admitted at trial he knew Shnaider would assume from this representation that BDW had paid $10 million. He knew that was false. A few days later, Shtaif travelled from Moscow to Toronto to obtain full access to Magellan's bank account. He paid Bokserman $1.5 million out of the Magellan account in satisfaction of their commission agreement.

[64] Shtaif also signed a letter of intent to purchase Reef Energy, a company that owned an oil field in Perm, Russia, and arranged for the purchase of US$12 million in treasury notes to acquire SibinTek. The trial judge described Shtaif's goal during this time, at para. 1008: "Shtaif was busy between April 5 and May 16 trying to divert funds from Magellan and making deals on behalf of Magellan that he would later use to convince the plaintiffs to stay in the venture."

[65] On April 28, the board met in London, England. All board members except "Howard" attended. Just before the meeting, Groag e-mailed "Howard" to tell him Shtaif had advised BDW's $10 million had been deposited. Groag asked for the balance to be expedited before the next board meeting.

[66] The trial judge found Shtaif misled Groag into believing BDW had paid the $10 million when he knew it had paid nothing. At the board meeting, Shnaider and Shyfrin demanded to know whether BDW's $10 million had been paid. De Freitas assured them it had just been transferred. Shnaider, Shyfrin and Groag believed him. Shtaif knew he was lying.

[67] Also at the April 28 board meeting, Shtaif informed the other directors he had signed agreements to acquire Reef and SibinTek on Magellan's behalf. [page495]

[68] On April 29, Groag gave notice to BDW, copied to all of the Magellan board members, that it was required to pay the final outstanding balance of US$60 million by June 2, 2006. Groag stated that if BDW failed to pay by that time, the board would meet to cancel any of BDW's shares that had not been paid in full. Shtaif said nothing, leading the respondents to continue to believe BDW's initial $10 million was in the bank.

[69] The trial judge found Shtaif was liable for fraudulent misrepresentation during this period because he knew Midland's $50 million was the only money in the venture. Had Shtaif told the respondents the truth that BDW had paid nothing, the respondents either would have sought immediate return of their $50 million or, at the very least, would have insisted on tighter controls over payments of the Magellan funds. By the time the respondents learned the truth, the trial judge held, millions of dollars of Midland's money had already been paid out.

F. *May 16, 2006: The respondents learn BDW has not paid anything*

[70] From May 15 to 17, 2006, Shtaif and Roberts met with investment bankers in Toronto to try to raise funds for an eventual Magellan initial public offering ("IPO"). On May 16, Roberts e-mailed Groag, Shnaider and Shyfrin reporting that based on these meetings, he thought they would be able to raise $300--500 million using tier-one and tier-two investment banks in Canada, "but only if we form an international syndicate of investment bankers".

[71] At trial, Roberts admitted he wrote this in his e-mail even though (i) he suspected the Magellan share price was being manipulated; (ii) Magellan was a Pink Sheet company with no prospects for being moved to a more reputable listing; and (iii) he knew that the investment banks would not invest in a Pink Sheet company.

[72] By this time, BDW had changed its corporate name to International/ILGY. In his May 16 e-mail, Roberts wrote International "will probably not be able to raise their full subscription amount in the time we have given them . . . In my view, it is important to get other strong institutions into the deal at this time at a good price."

[73] At a dinner on the evening of May 16, Shtaif finally disclosed to Shnaider that BDW/International had not paid anything. Shnaider asked how that was possible, given what De Freitas had said at the April 28 board meeting. Shtaif said De Freitas had misled him. He also revealed that, somehow, four million free trading shares in Magellan had been issued without [page496] board knowledge or approval. Shtaif told Shnaider Magellan would have to get rid of BDW and find other investors. He told Shnaider that would not be a problem; other investors were lined up to replace BDW.

[74] The following day, Shtaif and Roberts retained Allan Beach, a securities lawyer then at Fasken Martineau DuMoulin LLP ("Faskens"), to look into moving Magellan off the Pink Sheets onto a higher exchange. Although the trial judge made no finding on this point, she noted in her decision the suggestion made by respondents' counsel that Shtaif and Roberts hired Beach to discover what they already knew -- that it would not be possible to move Magellan to a higher exchange because it was a sham. Beach recommended the parties abandon Magellan and start afresh with a new company.

[75] The trial judge found Roberts and Shtaif were liable for fraudulent misrepresentation during this period. Roberts knew Magellan would not be able to raise $300--500 million because

it would not be possible to move it off the Pink Sheets. Shtaif overestimated the value of Reef and SibinTek to induce Midland to stay in the venture. He convinced Shnaider they had had a rough start, but going forward everything would be better. The trial judge found that Roberts and Shtaif made these misrepresentations with the intent to induce the respondents to stay in the venture.

G. *Late May--June 2006: Shtaif assures Midland all is well with the SibinTek transaction*

[76] The day after he revealed BDW never paid Magellan, Shtaif transferred US$12 million out of Magellan's account into that of his company, Euro Gas. He then converted the money into treasury notes he planned to use to buy SibinTek for Magellan.

[77] At this point, the narrative takes an extraordinary turn. Instead of putting the US$12 million in treasury notes in the name of Euro Gas, Shtaif had the endorsed treasury notes (the equivalent of cash) placed in a safety deposit box in the names of Vladimir Keloglu, his deputy at Euro Gas, and Tsygankov, the lawyer for Arthur Poltoranin who was the principal of a company called Reagent (by a later agreement Poltoranin was named as the client of the safety deposit box). Reagent purported to own 40 per cent of the shares of the vendor, SibinTek. However, at this time Magellan's lawyers in the Moscow office of White & Case LLP were still conducting due diligence on the proposed transaction and had not confirmed Reagent's claim of ownership in SibinTek. [page497]

[78] The respondents alleged Shtaif conspired with Poltoranin to misappropriate the US$12 million in treasury notes by entering into the safety deposit box agreement under which Poltoranin would have access to half of the treasury notes (US$6 million) even if Magellan did not close the SibinTek acquisition.

[79] The trial judge rejected Shtaif's contention that he was duped by Poltoranin and misled by the lawyers about the legal consequences of the safety deposit box agreement. She also rejected Shtaif's evidence that he told Shnaider and Shyfrin about the potential problem with the treasury notes. On the contrary, the trial judge found Shtaif assured them that Reagent had proper title to the SibinTek shares (which had not been confirmed) and the White & Case lawyers had advised that it was safe to close the SibinTek deal (which they had not).

[80] The trial judge found that during the period leading up to a Magellan board meeting on June 20, 2006, Shtaif continued to mislead the respondents, this time by misrepresenting to them that the SibinTek deal was on track to close. In fact, Shtaif knew there were serious problems with SibinTek. The trial judge held Shtaif lied to the plaintiffs to induce them to stay in the venture. She further found that, had the plaintiffs known the truth about what was happening with SibinTek at this time, they would not have continued with the venture or, if they did continue, they would have insisted on more stringent terms.

H. *June 20, 2006: Final Magellan board meeting and inaugural Koll board meeting*

[81] On June 20, 2006, Shnaider, Shyfrin, Groag, Roberts and Shtaif met and agreed to rescind the Magellan arrangement and reorganize their business venture under a legitimate public company, Koll. Initially, they agreed ownership would be divided 80/20 between Midland

and Shtaif, respectively. Shnaider and Shyfrin resigned from the Magellan board to avoid any conflict, and the remaining members voted to return to Midland what was left of its US$50 million investment in Magellan. The terms of this arrangement were memorialized in a June 21, 2006 settlement agreement between Midland and Magellan.

[82] Koll then held its inaugural board meeting on June 20, 2006.

[83] The trial judge found Shtaif continued to deceive the plaintiffs at the June 20 board meeting by failing to disclose the true state of affairs with the SibinTek acquisition. He knew there were significant title problems and a real risk the deal would not close. Shtaif also knew that should the SibinTek deal not close, Poltoranin could still access some of the treasury notes [page498] lodged in the safety deposit box. He made these misrepresentations to keep Midland's money in the deal, knowing that the respondents would rely on them.

[84] On July 13, 2006, Koll purchased Reef for US$18.5 million using money loaned from Midland.

[85] By July 15, 2006, the problems with the SibinTek deal and the treasury notes came to light. Shyfrin wanted to back out of the joint venture, but Shnaider persuaded him to stay.

[86] Shnaider and Shyfrin, however, made their continued participation conditional. They insisted on financial control of Koll and that Midland's in-house lawyers be involved in every transaction going forward. They also insisted that rather than investing US$50 million in Koll, they would advance US$50 million as a loan to the company. They would also retain 67 per cent of the shares. Shtaif would hold the remaining shares to distribute as he saw fit. Shtaif agreed to the new terms, but he testified he signed the loan agreement "under duress", at a Moscow police station with a (literal) gun on the table. The trial judge rejected his dramatic account.

I. *The Magellan promissory notes*

[87] The trial judge found that after the parties terminated the Magellan arrangement, Shtaif and Roberts unlawfully conspired to convert to their own use Magellan money left in Faskens' trust account and a TD Bank account. They did so even though they knew that any money remaining in Magellan's account following the June 20 board meeting was to be returned to Midland under the terms of the settlement agreement.

[88] Roberts obtained the Magellan funds in the following manner. Unbeknownst to the respondents, just before resigning as Magellan's CEO, Shtaif signed Magellan promissory notes to himself (over US$1.28 million) and Roberts (US$44,796) as reimbursement for expenses they purportedly incurred while acting for Magellan. Roberts later discovered some Magellan funds remained with Faskens ($39,570.66) and in Magellan's TD Bank account ($100,482.02).

[89] Roberts thereupon commenced two actions on the promissory notes in the Ontario Superior Court of Justice. He moved for consent judgments on the two promissory notes in a manner that can only be described as misleading the court -- he arranged for Boock/Krakowsky/Howard, now using the alias John Sparrow, to consent to judgment on behalf of Magellan when he had no authority to do so. Roberts then garnished the funds in the Faskens and TD accounts in satisfaction of the judgments. Neither Roberts nor Shtaif told the respondents [page499] about the remaining Magellan funds or their efforts to recover them for

their own purposes.

J. *Events after July 15, 2006*

[90] The trial judge found that even after the SibinTek debacle had come to light, Shtaif continued to trumpet his oil expertise and to insist the respondents rely on that expertise. The trial judge accepted Shnaider's evidence that he thought that if Shtaif could find oil assets and Koll were taken public, Midland would be able to recoup its losses.

[91] The trial judge found Shtaif and Roberts misrepresented the value of the assets Koll owned -- for example, they represented to the plaintiffs that Reef alone was worth at least US$156 million, and that post-IPO Koll would be worth at least US$600 million. The trial judge found Shtaif and Roberts knew these valuations were "false and unsupportable". They based their estimates on reserves that had not yet been acquired, and knowing the existing reserves fell well below the reserves being assumed by the investment bankers for a successful IPO.

[92] The trial judge found that but for the ongoing assurances about the value of Reef, the excitement of the investment bankers, and the likely success of the IPO, the respondents would not have continued to fund Reef up to the aggregate of US$50 million.

K. *The aftermath*

[93] Throughout the second half of 2006, the parties' relationship deteriorated, with Shtaif and Roberts fighting Shnaider and Shyfrin for control of Koll.

[94] The trial judge found that after July 15, 2006, Shtaif plotted with Roberts to unwind the "nasty arrangements" regarding the ownership of Koll to which he had freely agreed. After November 2006 at the latest, they schemed to exclude Midland and take control of Koll's assets. Although this constituted inducing breach of contract and unlawful act conspiracy, no compensable damage to the respondents resulted.

[95] On March 5, 2007, Roberts e-mailed Beach, the Faskens securities lawyer he had retained, a letter setting out his and Shtaif's strategy to move the shares of Koaplama (a Koll subsidiary that owned Reef) to a company controlled by Shtaif and "out of the reach of [Shnaider and Shyfrin]". Beach testified, and the trial judge accepted, that he did not approve this "illegal" plan and Roberts and Shtaif did not seek confirmation from Beach that transferring Reef to new ownership was legal. [page500]

[96] The respondents immediately moved to take control of Reef (Koll's sole asset) by terminating a management agreement between Euro Gas and Reef and entering into a new agreement with Midland. This allowed the respondents to avoid any injury Shtaif's and Roberts' conspiracy otherwise would have caused.

[97] The trial judge rejected Shtaif's claim that this transfer of Reef was illegal; she held the respondents had good reason to be concerned Shtaif and Roberts would try to take Reef away from Koll, and they acted in Reef's best interests in effecting the change.

[98] After several unsuccessful attempts, the respondents sold Reef in 2010 for US$5 million. It was uncontested that, all told, Midland loaned Koll US$50 million, and that its losses totalled US$46,105,879.50. In their action against the defendants, the plaintiffs claimed a return of that

amount, plus interest and punitive damages. The trial judge declined to award punitive damages, without giving reasons.

L. *The trial judge's damages awards*

[99] In the end, the trial judge ordered judgment of US$8.27 million against Boock and De Freitas for fraudulent misrepresentation and unlawful conspiracy in setting up the fraud in 2005. That figure represented the respondents' losses up to May 16, 2006, when they realized that the corporate vehicle Boock and De Freitas had set up to facilitate the joint venture was a sham.

[100] The trial judge ordered judgment of US$1.5 million against Bokserman for fraudulent misrepresentation in inducing the respondents to invest in the joint venture based on information he knew to be wrong. That figure represented the commission Bokserman earned by introducing the respondents to the appellants.

[101] The trial judge ordered judgment of US$59.6 million against Shtaif and Roberts for fraudulent misrepresentation and breach of fiduciary duty for continuing to deceive the plaintiffs after the initial fraud had come to light. That figure represented the respondents' total loss on the joint venture. The trial judge awarded these funds to Midland. She did not award anything to Shnaider and Shyfrin in their personal capacities.

[102] The trial judge was clear that without the "further misrepresentations" Shtaif and Roberts made to the plaintiffs after July 15, 2006 about the value of the assets and the prospects for a successful IPO, she would have "seriously questioned" whether the respondents were justified in continuing to pour money into the project in order to mitigate their earlier losses. She noted [page501] that by that time, Midland had spent a further US$18.5 million to purchase Reef. Its total loss by July 15, 2006 was US$26.77 million. As I will explain, I am satisfied that the trial judge should not have awarded Midland damages for advances it made after the June 21, 2006 reorganization using Koll as the new corporate vehicle.

[103] The trial judge went on to dismiss the defendants' counterclaims.

[104] Bokserman, Shtaif and Roberts now appeal the judgments against them. Roberts appeals the dismissal of his counterclaim; Shtaif does not appeal the dismissal of his. Boock was noted in default; De Freitas moved shortly before oral argument to have his appeal dismissed on consent.

III. *The Issues on these Appeals*

[105] The appellants raise some common issues; others are unique to each appellant. As well, the issues divide into two temporal groups: those concerning the appellants' conduct pre-dating the June 21, 2006 settlement agreement, and those based on their conduct thereafter. Accordingly, I will deal with the appellants' grounds of appeals in the following order:

A. Common issues raised by all appellants

(i) Does the rule in *Foss v. Harbottle* preclude the respondents from asserting their claims without seeking leave to commence a derivative action?

(ii) Does the settlement agreement preclude the respondents from seeking damages for the appellants' pre-June 21, 2006 conduct?

B. Bokserman's appeal: pre-June 21, 2006 issues

(i) Did the trial judge err in finding Bokersman liable for fraudulent misrepresentation?

C. Roberts' appeal: pre-June 21, 2006 issues

(i) Did the trial judge err in finding Roberts liable for breach of fiduciary duty in respect of his silence about material facts at the February 19, 2006 Magellan board meeting?

(ii) Did the trial judge err in finding Roberts liable in deceit for statements made in his May 16, 2006 e-mail to the Magellan board? [page502]

D. Shtaif's appeal: pre-June 21, 2006 issues

(i) Did the trial judge err in finding Shtaif liable for US$8.27 million for deceit, breach of fiduciary duty and unlawful conduct conspiracy?

E. Appeals of Shtaif and Roberts: post-June 21, 2006 issues

(i) Did the trial judge err in finding Shtaif and Roberts liable for deceit in respect of their IPO-related statements regarding the value of Koll?

(ii) Did the trial judge err in finding Shtaif and Roberts liable for recovering Magellan funds for their own use?

F. Mitigation

(i) Did the trial judge err in finding the respondents had not failed to mitigate their damages?

G. Roberts' appeal of the dismissal of his counterclaim

(i) Did the trial judge err in dismissing Roberts' appeal from the dismissal of his counterclaim?

IV. *Common Issues*

A. *Standing: The application of the rule in Foss v. Harbottle*

The issue stated

[106] The appellants argue that if they committed any legal wrongs, the entities directly injured by their acts were the corporations -- Magellan and, subsequently, Koll -- not their shareholders, the respondents. As a result, the rule in *Foss v. Harbottle* prevents the respondents, as shareholders, from bringing suit to recover damages for any wrongs caused to the corporations, Magellan and Koll, absent leave to bring a derivative action, which the respondents did not seek: *Hercules Managements Ltd. v. Ernst & Young*, [1997] 2 S.C.R. 165, [1997] S.C.J. No. 51, at para. 59; *BCE Inc. v. 1976 Debentureholders*, [2008] 3 S.C.R. 560, [2008] S.C.J. No. 37, 2008 SCC 69, at para. 43. The appellants therefore contend the trial judge erred in law by granting any judgment in favour of Midland.

[107] The respondents state the appellants are raising the *Foss v. Harbottle* argument for the first time on appeal, and the court should decline to entertain it on this basis alone. In any event, they argue this submission is misconceived: the respondents did not sue as shareholders of Magellan and Koll seeking damages for wrongs done to those corporations, but as investors [page503] who were duped by the appellants into pouring millions of dollars into a sham public company, Magellan, and then induced to throw good money after bad by re-investing in Koll in an effort to recoup their losses.

[108] The respondents further submit that even if the rule in *Foss v. Harbottle* applies, it only affects their fiduciary duty claims against Shtaif and Roberts as those are the only ones which could be characterized as derivative. By contrast, the fraudulent misrepresentation and unlawful conspiracy claims are personal ones by the respondent investors against those who induced them to invest in Magellan and Koll.

Analysis

(1) *The appellants did not specifically plead the claim was barred by the rule in Foss v. Harbottle*

[109] Rule 25.07(4) of the Rules of Civil Procedure, R.R.O. 1990, Reg. 194 requires a defendant to plead any matter on which he intends to rely to defeat the claim of the opposite party and which, if not specifically pleaded, "might take the opposite party by surprise or raise an issue that has not been raised in the opposite party's pleading". This requires a party to plead an affirmative defence, such as a plaintiff's lack of standing to sue: *Concord Kitchens GP Inc. v. Eastern Construction Co.*, [2010] O.J. No. 1597, 2010 ONSC 2168 (S.C.J.), at paras. 102-105; *Huber v. Way*, [2014] O.J. No. 3498, 2014 ONSC 4426 (S.C.J.), at paras. 66-68.

[110] The reason for this pleading rule is quite simple. The just determination of a civil proceeding on its merits requires a fair adjudicative process. Trial by ambush is not fair. Accordingly, trial unfairness may result where a defendant is permitted to rely on an unpleaded defence which, if pleaded, might have prompted counsel to employ different tactics at trial: *Strong v. Paquet Estate* (2000), 50 O.R. (3d) 70, [2000] O.J. No. 2792 (C.A.), at para. 37, leave to appeal to S.C.C. refused [2000] S.C.C.A. No. 532. As this court stated in *Hav-A-Kar Leasing Ltd. v. Vekselshtein*, [2012] O.J. No. 5592, 2012 ONCA 826, at paras. 69-70:

> The failure to raise substantive responses to a plaintiff's claims until trial or, worse, until the close of trial, is contrary to the spirit and requirements of the *Rules of Civil Procedure* and the

> goal of fair contest that underlies those Rules. Such a failure also undermines the important principle that the parties to a civil lawsuit are entitled to have their differences resolved on the basis of the issues joined in the pleadings[.]
>
> [W]here a defence to a civil action is not pleaded and no pleadings amendment is obtained, judges should generally resist the inclination to allow [page504] a defendant to raise and rely on the unpleaded defence if trial fairness and the avoidance of prejudice to the plaintiff are to be achieved.

[111] The rule is not absolute. This court has excused defendants from their failure to raise an affirmative defence in the pleadings where the issue was otherwise clearly raised and put in issue before trial: *Reliable Life Insurance Co. v. M.H. Ingle & Associates Insurance Brokers Ltd.* (2002), 59 O.R. (3d) 1, [2002] O.J. No. 1382 (C.A.), at para. 36. However, raising a potentially dispositive issue during closing submissions, after the close of evidence, may well prove too late.

[112] In the present case, Shtaif acknowledged in oral argument that he was raising a *Foss v. Harbottle* argument for the first time on appeal. On his part, Roberts appears to have raised *Foss v. Harbottle* for the first time at trial in a short passage in his written closing and then his oral closing submissions. However, the appellants did not raise the issue in any of their pleadings, or in their opening written or oral statements at trial.

[113] There are two procedural reasons why I would not give effect to the appellants' *Foss v. Harbottle* argument.

[114] First, the appellants' tardiness in raising this defence and waiting until the appeal to raise it in any substantive way works an unfairness on the respondents: *Kaiman v. Graham*, [2009] O.J. No. 324, 2009 ONCA 77, 45 E.T.R. (3d) 163, at para. 18. Had they specifically pleaded a *Foss v. Harbottle* defence, the respondents submit they could have sought leave to bring a derivative action *nunc pro tunc*. Instead, the respondents only had a limited opportunity to reply to Roberts' last-minute raising of the defence.

[115] Second, the appellants' submission is inconsistent with the position they took at trial on their counterclaims. Shtaif and Roberts did not view the rule in *Foss v. Harbottle* as precluding their counterclaims against the respondents based on allegations the parties were fiduciaries in respect of the Koll portion of their business venture. Accordingly, there is merit in the respondents' submission that had the appellants pleaded a *Foss v. Harbottle* defence, they would have undercut the foundation for their own counterclaims.

(2) *The respondents' allegations of fraudulent misrepresentation and conspiracy are direct, personal claims that are not barred by the rule in Foss v. Harbottle*

[116] In any event, the appellants' submission mischaracterizes the real nature of the respondents' claims. The respondents [page505] do not allege the directors of Magellan or Koll failed to exercise the requisite care and diligence in discharging their duties by mismanaging those corporations' investments in oil fields, thereby causing financial losses that harmed the respondents as shareholders. Instead, the respondents allege the individual appellants engaged in deceit and conspiracies to induce them to part with their money and invest in Magellan and

Koll. Those claims are personal in nature, seeking damages for tortious harm directly caused to the respondents.

[117] The rule in *Foss v. Harbottle* does not preclude a shareholder from maintaining a claim for harm done directly to it: *Meditrust Healthcare Inc. v. Shoppers Drug Mart, a Division of Imasco Retail Inc.* (2002), 61 O.R. (3d) 786, [2002] O.J. No. 3891 (C.A.), at para. 16. As this court stated in *Goldex Mines Ltd. v. Revill* (1974), 7 O.R. (2d) 216, [1974] O.J. No. 2245 (C.A.), at p. 221 O.R.: "Where a legal wrong is done to shareholders by directors or other shareholders, the injured shareholders suffer a personal wrong, and may seek redress for it in a personal action." This principle was reiterated in *Hercules Managements Ltd. v. Ernst & Young*, where the Supreme Court stated, at para. 62:

> [S]hareholders cannot raise individual claims in respect of a wrong done to the corporation . . . Where, however, a separate and distinct claim (say, in tort) can be raised with respect to a wrong done to a shareholder *qua* individual, a personal action may well lie, assuming that all the requisite elements of a cause of action can be made out.

[118] The Quebec Court of Appeal recently canvassed the issue of direct versus indirect harm in its decision in *Groupe d'action d'investisseurs dans Biosyntech v. Tsang*, [2016] Q.J. No. 17247, 2016 QCCA 1923, dismissing an appeal from the motion judge's refusal to certify a class action brought by shareholders against directors of the corporation for loss in share value. In the course of considering whether the damages claimed by the shareholders were direct or indirect -- the core issue in the case -- the Quebec Court of Appeal observed, at para. 31:

> Another example of direct damage suffered by a shareholder resulting from the acts of a director was described by the judge as the hypothetical case of the shareholder who purchases his shares based on the negligent or fraudulent misrepresentation of directors. Such a scenario causes the shareholder to have parted with his money to buy worthless shares and thus, suffers harm independent from the company giving rise to a good cause of action against directors for damages directly suffered by the shareholder.

[119] The trial judge found on the "unusual facts" of this case that Midland, the shareholder, did suffer a direct injury or loss by reason of the appellants' conduct. I see no error in those [page506] findings. The appellants' conduct caused Midland to invest moneys in Magellan, providing that company effectively with its sole source of operational funding. Midland claims for the loss of that investment. That distinguishes the present case from the typical "indirect loss" case in which a shareholder seeks to recover the loss of share value because the manner of operations of the corporation depressed the market price for its stock.

[120] Consequently, the rule in *Foss v. Harbottle* does not apply to the respondents' claims for fraudulent misrepresentation and conspiracy. I will deal with their claims for breach of fiduciary duty later in these reasons.

B. *The effect of the settlement agreement on the respondents' claims*

The issue stated

[121] The June 21, 2006 settlement agreement brought the Magellan venture to an end, with the parties reconstituting their oil field development project in Koll. The settlement agreement was between two parties only -- Magellan and Midland. It defined Midland's earlier purchase of Magellan shares for $50 million as the "Acquisition", and s. 1 stated: "The Acquisition is hereby rescinded." Midland returned its share certificate to Magellan. In consideration for the certificate's return, in s. 2 of the settlement agreement Magellan agreed to (i) pay Midland "in immediately available funds" US$36.328 million; (ii) assign to Midland all of its rights in the two Magellan subsidiaries involved in the SibinTek and Reef transactions, as well as those transactions' purchase agreements; and (iii) issue Midland a Magellan secured demand promissory note for US$1.67 million, which covered, in part, the commission paid to Bokserman.

[122] The appellants submit the trial judge failed to appreciate the settlement agreement prevented the respondents from bringing action on any torts committed before June 21, 2006 because under the agreement Magellan and Midland were deemed to release one another as of June 20, 2006.

[123] As with the first issue, the respondents submit the appellants are raising this argument for the first time on appeal and the court should not consider it. In any event, they say the argument ignores the fact that when the settlement agreement was made, the respondents were not aware Shtaif was involved in a conspiracy with Boock/Krakowsky/"Howard" and De Freitas, or that Shtaif had deceived them about the status of the SibinTek transaction. In those circumstances, they submit, [page507] rescission of the Magellan agreement cannot absolve the appellants of liability.

Analysis

[124] The appellants did not plead that the settlement agreement operated to release all pre-June 21, 2006 claims, nor did they raise the defence at trial. On that basis alone, it is not now open to them to assert such a defence as a ground for setting aside the judgment.

[125] In any event, the appellants' submission cannot succeed. The terms of the settlement agreement, and the circumstances surrounding its making, do not support the appellants' argument that the agreement constituted an unequivocal expression by the respondents to rescind Midland's share subscription in Magellan by reason of the appellants' fraud and thereby place all parties *in status quo ante*: *Guarantee Co. of North America v. Gordon Capital Corp.*, [1999] 3 S.C.R. 423, [1999] S.C.J. No. 60, at para. 39.

[126] First, the appellants were not parties to the settlement agreement; it contains no terms for their benefit.

[127] Second, Midland gave no release of claims in the agreement; by contrast, Magellan released the respondents.

[128] Third, the settlement agreement contained no provision purporting to release the appellants from claims unknown to the respondents at the time the agreement was made. As of June 21, 2006, the respondents were not aware of the extent of the risk to the SibinTek treasury notes, which ultimately resulted in a loss of just over $6 million of the funds invested by Midland. As a result, notwithstanding the assignment of Magellan's rights in the SibinTek transaction, the respondents suffered a loss caused by Shtaif's deceitful conduct.

[129] Finally, the Magellan promissory note lacked any value; it did not result in Midland recouping the funds used to pay Bokserman his commission because Magellan never had any assets other than the funds invested by Midland.

[130] I therefore would not give effect to this ground of appeal.

V. *Bokserman's Appeal: Other Grounds Concerning Pre-June 21, 2006 Issues*

[131] The trial judge held that in their late 2005 meeting with Shnaider, Shtaif and Bokserman misrepresented that BDW was a "sophisticated Bay Street investor" committed to investing US$70 million in Magellan. She held: (i) the statement was false; (ii) Bokserman knew the statement was false because, as an investment advisor, he understood investment bankers and [page508] banks were wary of Pink Sheets companies, such as BDW; (iii) he intended the respondents to invest in Magellan based on "his representation that BDW was what he knew it not to be"; (iv) Shnaider relied on Bokserman's representation in causing Midland to invest in Magellan; and (v) Midland suffered damages as a result. The trial judge granted judgment against Bokserman in the amount of the $1.5 million commission Magellan paid him using funds invested by Midland.

[132] Bokserman advances three reasons why the trial judge erred in holding him liable for fraudulent misrepresentation.

[133] First, Bokserman submits his representation to Shnaider that BDW was a sophisticated Bay Street investor was true because it was never proven at trial that the individuals behind BDW were not sophisticated Bay Street investors. This submission runs aground on the trial judge's findings, which were not contested, that the person behind BDW -- Boock/ Krakowsky/Howard -- had a criminal record, including convictions for fraud, was prohibited from trading by the Ontario Securities Commission, and was operating under an alias or changed name.

[134] Second, Bokserman argues the alleged misrepresentations concerned BDW's future intentions to invest US$70 million in Magellan and, as such, were not actionable statements of fact.

[135] I disagree. Bokserman's representations were based on an existing, purported "fact": that BDW was made up of sophisticated Bay Street investors who were committed to funding the Magellan venture. The fact they had not yet advanced funds is irrelevant.

[136] Finally, Bokserman advances a three-pronged argument disputing the respondents suffered damages as a result of his misrepresentations. The first prong challenges the trial judge's findings that without Bokserman's assurances, the respondents would not have invested in Magellan and Bokserman would not have received his US$1.5 million commission -- a commission paid using Midland's investment.

[137] While the respondents' pleading alleged Bokserman's representation led Shnaider to "express an interest" in investing, the evidence at trial was that Shnaider relied on Bokserman's representation in deciding to invest. It was open to the trial judge to make the findings of reliance she did on the record before her. I see no basis for appellate interference with them. Moreover, the respondents were not required to establish that they relied only on that misrepresentation, simply that it contributed to their decision and was one of the facts that induced [page509] them

to act: *Fiorillo v. Krispy Kreme Doughnuts, Inc.* (2009), 98 O.R. (3d) 103, [2009] O.J. No. 2430 (S.C.J.), at para. 91.

[138] The second prong contends Midland cannot recover damages because it was Magellan that paid Bokserman's commission. Of course, the only funds Magellan had came from Midland. This argument essentially is a variant of the *Foss v. Harbottle* submission, which I have rejected.

[139] The final prong argues Midland suffered no damage because under the settlement agreement it received a Magellan promissory note that covered, in part, the amount of the commission paid to Bokserman. Apart from the financial reality that the note lacked any value, the settlement agreement did not contain any release of claims by Midland against Bokserman.

[140] For these reasons, I would dismiss Bokserman's appeal.

VI. *Roberts: Other Grounds of Appeal Concerning Pre-June 21, 2006 Events*

[141] The trial judge held Roberts breached his fiduciary duty to Magellan by not disclosing material information at the February 19, 2006 board meeting (the true identity of "Howard" and his criminal record) and committed a deceit in a May 16, 2006 e-mail (reporting Magellan would be able to raise $300 --500 million). The trial judge found these breaches caused damages to Midland by June 20, 2006 of $8.27 million. Roberts submits the trial judge erred in making both findings.

[142] In this section, I deal with the trial judge's finding of breach of fiduciary duty. I conclude the trial judge erred in finding Midland could recover the loss as the beneficiary of a fiduciary duty. Nevertheless, her liability finding of $8.27 million must be upheld, as it is properly characterized as liability for fraudulent misrepresentation. I will consider Roberts' submissions about the trial judge's May 16, 2006 e-mail deceit finding in Part VIII below, together with similar submissions made by Shtaif.

A. *Breach of fiduciary duty: The issue stated*

[143] All Magellan directors, including Shnaider and Shyfrin, attended the company's February 19, 2006 board meeting in Moscow (the "February board meeting"). It was Roberts' first directors' meeting. The trial judge held Roberts breached his fiduciary duty as a director by failing to disclose to the board material information, including that "Howard" really was Boock/Krakowsky, who had a criminal record for fraud and was using a changed name or alias. The trial judge accepted the evidence of Shnaider and Shyfrin that had Roberts disclosed such [page510] information to the board, they would not have proceeded with Magellan.

[144] The trial judge tersely explained the basis of her finding of liability, at para. 1178, stating:

> I have found Roberts breached his fiduciary duty to disclose material information to the Magellan Board on February 19, 2006 that Howard was Boock and that he had a criminal record. Had Roberts done so, the rescission of Midland's contract would have been unnecessary and Midland would not have suffered a direct resulting loss of $8,270,000 net. While Roberts's and Shtaif's and De Freitas's fiduciary duty was to Magellan, on the unusual facts here their breaches of their duties to Magellan caused Midland's damages of $8,270,000.

[145] Roberts concedes he owed a fiduciary duty to Magellan, but submits the trial judge erred by allowing Midland to recover damages for his breach of it. He submits that as a Magellan director, he owed a fiduciary duty only to the corporation, not to its shareholders, following *BCE*, at para. 66. Since the respondents did not have a direct cause of action against him as the beneficiaries of a fiduciary duty, and since they did not bring a derivative action in respect of any damages caused by his breach to Magellan, Roberts contends the trial judge erred in granting Midland damages for his failure to disclose material facts at the February board meeting.

[146] The respondents reply that Roberts' conduct caused Midland a direct, personal harm as a shareholder because it lost its investment. The trial judge therefore was entitled to find Roberts liable for that harm.

B. *Analysis*

Roberts' conduct at the February board meeting

[147] The analysis must start with an examination of Roberts' conduct at the February board meeting. Was he under a duty to disclose what he knew about "Howard's" criminal background and name change? Unquestionably he was.

[148] Directors must serve the corporation selflessly, honestly, loyally and in good faith; they must avoid abusing their position to gain personal benefit: *Peoples Department Stores Inc. (Trustee of) v. Wise*, [2004] 3 S.C.R. 461, [2004] S.C.J. No. 64, 2004 SCC 68, at para. 35. These fiduciary duties flow from the trust and confidence shareholders repose in the directors to manage the corporation's assets, including those transferred to the corporation by the shareholders: *Peoples*, at paras. 34-35.

[149] As a result, a director owes a corporation a fiduciary duty to act honestly, which includes a duty to disclose material information: see, generally, Kevin P. McGuinness, [page511] *Canadian Business Corporations Law*, 2nd ed. (Markham, Ont.: LexisNexis, 2007), at 11.40; *484887 Alberta Inc. v. Faraci*, [2002] A.J. No. 522, 2002 ABQB 406, 311 A.R. 355, at para. 28, citing *Jackson v. Trimac Ltd.*, [1994] A.J. No. 445, 1994 ABCA 199, 20 Alta. L.R. (3d) 117, at p. 5 (QL).

[150] Roberts submits the information he possessed about "Howard's" criminal background and his change of name were not material because, by the time of the February board meeting, Midland already had signed the agreement to subscribe for Magellan shares. That argument is a non-starter. First, such information struck at the root of the legitimacy of Magellan as a public company, and Roberts was required to disclose it regardless of whether the respondents had made some, all or none of their investment in Magellan. The trial judge accepted Shnaider's evidence that had Roberts disclosed this information, he would have realized that this was a "pump and dump" scheme and would have declined to further participate in Magellan. There is no basis upon which to interfere with that finding.

[151] Moreover, while Midland signed the share subscription agreement in January 2006, it did not advance its $50 million to Magellan until early April 2006, well after the February board meeting.

[152] Given what Roberts knew about "Howard's" criminal past, he had two options. First, as the trial judge pointed out [at para. 109], if he believed the information was privileged and non-

disclosable because he had obtained it during the course of doing prior legal work for Boock/Krakowsky/Howard, "given its materiality, he should not have agreed to join the Board". From the trial judge's findings, it is clear why Roberts did not take that option. He had much to gain personally by Midland's injection of funds into Magellan -- the appreciation in value of his two million Magellan shares and a US$80,000 annual director's fee.

[153] Roberts' second option was to open his mouth and tell his fellow directors about "Howard's" real identity and criminal past. That he did not do, no doubt for the same reason of not wanting to jeopardize any future personal gain.

[154] So, Roberts kept silent. In so doing, he egregiously breached his duty as a director to make timely disclosure of material information to Magellan's board.

Midland cannot recover against Roberts on the basis of breach of fiduciary duty

[155] Roberts contends his silence at the February 2006 board meeting attracts no legal liability to Midland because his [page512] director's duty was owed only to Magellan and, as a result, Midland cannot recover any damages resulting from it.

[156] Directors owe their fiduciary obligation to the corporation: *Peoples*, at para. 43; *BCE*, at para. 66. And, in *BCE*, the Supreme Court of Canada noted that "[n]ormally only the beneficiary of a fiduciary duty can enforce the duty": para. 41. The court acknowledged this could work a harsh result because "[t]he directors who control the corporation are unlikely to bring an action against themselves for breach of their own fiduciary duty": para. 41. However, in light of the availability of several other remedies to shareholders -- such as the oppression remedy, a derivative action or an action based on a director's duty of care -- the Supreme Court has resisted characterizing corporate stakeholders as the beneficiaries of directors' statutory fiduciary duties: *Peoples*, at para. 53; *BCE*, at paras. 42-45.

[157] That said, a director may owe an *ad hoc* fiduciary duty to a shareholder, especially in "situations involving a family or other close special relationships of trust and dependency between the claimant and the defendant director, in which the director was seeking to take advantage of that relationship for personal gain or profit": Kevin McGuinness, *Canadian Business Corporations Law*, 2nd ed., at 11.194; *Harris v. Leikin Group Inc.*, [2013] O.J. No. 1097, 2013 ONSC 1525 (S.C.J.), at paras. 401-402, affd (2014), 120 O.R. (3d) 508, [2014] O.J. No. 2914, 2014 ONCA 479. However, although the respondents pleaded the existence of an *ad hoc* fiduciary duty owed by Roberts to Shnaider and Shyfrin, the trial judge made no factual findings that such a duty arose in the circumstances.

[158] Thus, on the current state of the law, the trial judge's implicit holding that Midland, as a shareholder, enjoyed a cause of action against Roberts for his breach of fiduciary duty to Magellan is not sustainable.

Midland can recover against Roberts for fraudulent misrepresentation

[159] Although the trial judge erred in concluding Midland could recover its loss as the beneficiary of a fiduciary duty Roberts owed to Magellan, I see no error in the trial judge's finding that Midland suffered a loss of US$8.27 million as a direct result of Roberts' failure to disclose material information at the Magellan February board meeting.

[160] As discussed earlier in this judgment, the rule in *Foss v. Harbottle* was not an obstacle to the respondents' claims. Midland therefore could sue to recover its direct loss. [page513]

[161] The trial judge's error lay not in attaching liability to Roberts for his silence about "Howard's" background at the February board meeting, but in finding liability on the basis of breach of fiduciary duty, instead of on the alternative basis advanced by the respondents in their closing submission -- fraudulent misrepresentation.

[162] Fraudulent misrepresentation is established where there are the following five elements: (i) a false representation of fact by the defendant to the plaintiff; (ii) knowledge the representation was false, absence of belief in its truth, or recklessness as to its truth; (iii) an intention the plaintiff act in reliance on the representation; (iv) the plaintiff acts on the representation; and (v) the plaintiff suffers a loss in doing so: *Amertek Inc. v. Canadian Commercial Corp.* (2005), 76 O.R. (3d) 241, [2005] O.J. No. 2789 (C.A.), at para. 63, leave to appeal to S.C.C. refused [2005] S.C.C.A. No. 439.

[163] A misrepresentation can involve not only an overt statement of fact, but also certain kinds of silence: the half-truth or representation that is practically false, not because of what is said, but because of what is left unsaid; or where the circumstances raise a duty on the representor to state certain matters, if they exist, and where the representee is entitled, as against the representor, to infer their non-existence from the representor's silence as to them: Robert Van Kessel and Paul Rand, *The Law of Fraud in Canada* (Toronto: LexisNexis, 2013), at 2.69 and 2.72.

[164] The significance of silence always falls to be considered in the context in which it occurs: *Demagogue Pty. Ltd. v. Ramensky* (1992), 39 F.C.R. 31, 110 A.L.R. 608 (Aus. F.C.), at p. 32 F.C.R. As explained by Professor Waddams: "Almost always something is said to induce the transaction and it is open to the court to hold that the concealment of the material facts can, when taken with general statements, true in themselves but incomplete, turn those statements into misrepresentations": S.M. Waddams, *The Law of Contracts*, 6th ed. (Aurora, Ont.: Canada Law Book Inc., 2010), at para. 439.

[165] In the present case, the trial judge relied, in part, on the minutes of the February board meeting to find that Roberts did not disclose "Howard's" real identity and conviction for fraud or that Roberts had acted for "Howard" in the past.

[166] Those minutes reveal two critical facts about the context in which the board's discussion took place. First, Roberts was identified as a director "representing the interests of BDW Holdings Ltd.", the touted senior investor in Magellan associated with "Howard". [page514]

[167] Second, the minutes show the board agreed that the initial subscribers for Magellan shares -- the most significant of which were BDW and Midland -- were to pay for their subscriptions within 21 days. Notwithstanding that Roberts concurred in that board decision, as his signature to the minutes attests, he remained silent about the true identity and criminal past of the principal behind the largest subscriber, BDW, the company whose interests other Magellan directors understood he was representing. Roberts' silence on those material facts lent an air of legitimacy to BDW as the senior subscriber for Magellan shares that BDW did not possess because of "Howard's" involvement in it.

[168] Further, the discussion at the February board meeting, as recorded in the minutes, made it clear to Roberts that Midland was being asked to pay for its Magellan shares within 21 days. Roberts therefore knew that his silence about the true identity and criminal past of BDW's principal would result in Midland investing funds in Magellan in ignorance of BDW's real circumstances.

[169] In short, the trial judge's findings disclose Roberts knew the information he possessed about "Howard's" criminal past and name change was material, and he intended the respondents to rely on the favourable impression about BDW created by his silence. The respondents acted to their detriment in relying on Roberts's non-disclosure and the trial judge accepted [at para. 983] that "had [this] information been disclosed to the Magellan Board, the Board would not have proceeded with Magellan". Midland suffered a direct loss as a result.

[170] But, the respondents did not specifically plead that Roberts' silence amounted to a fraudulent misrepresentation. Does such an omission require this court to set aside that part of the judgment imposing US$8.27 million liability on Roberts to Midland for his pre-June 21, 2006 conduct? In my view, it does not.

[171] Yet, later in these reasons I conclude the respondents' failure to plead fraudulent misrepresentation justifies setting aside most of that portion of the judgment in respect of the post-June 21, 2006 conduct of Roberts and Shtaif. Is it inconsistent to uphold part of the judgment on a basis not specifically pleaded, but set aside another part by reason of want of a proper pleading? I think not; the circumstances of the two situations differ materially.

[172] Unlike the circumstances in respect of that part of the judgment based on the post-June 21, 2006 IPO-related statements of Roberts and Shtaif, the respondents clearly pleaded [page515] Roberts committed a wrongful act by not disclosing material information about "Howard" at the February board meeting and Midland suffered a loss as a result. The respondents also squarely put in issue Roberts' wrongful conduct at the February board meeting and the relief they sought for it during the trial, directly cross-examining Roberts on the point. In their closing submission, they also advanced fraudulent misrepresentation by silence as an alternative basis for finding Roberts liable in respect of the February board meeting. Accordingly, I see no unfairness to Roberts by upholding this part of the judgment -- throughout the trial he knew the case he had to meet in respect of his conduct at the February board meeting.

[173] For the reasons set out above, I see no error in the trial judge granting judgment against Roberts for US$8.27 million "on the unusual facts here".

[174] Although that is sufficient to dismiss Roberts' appeal of that portion of the judgment awarding damages of US$8.27 million for Midland's pre-June 21, 2006 losses, I intend to deal with Roberts' additional ground of appeal that the trial judge erred in finding him liable in deceit for statements made in a May 16, 2006 e-mail. However, since that ground of appeal raises issues similar to those concerning her findings of deceit against both Shtaif and Roberts for post-June 21, 2006 statements, I will deal with all the statements together in Part VIII below.

VII. *Shtaif's Appeal: Other Grounds Concerning Pre-June 21, 2006 Conduct*

Liability for deceit

[175] The trial judge found Shtaif liable to Midland for deceit and unlawful conspiracy in respect of conduct that took place before June 21, 2006, which caused Midland damages of $8.27 million. The trial judge calculated the $8.27 million by deducting the amount of the SibinTek treasury notes recovered by Midland ($5.4 million) from the aggregate of $13.67 million in Midland funds that Magellan used to fund the failed SibinTek transaction, together with the commission paid to Bokserman.

[176] Some of the pre-June 21, 2006 fraudulent misrepresentations for which the trial judge found Shtaif liable were (i) stating BDW was a sophisticated Bay Street investor committed to investing US$70 million in the venture; (ii) as of December 20, 2005, BDW already had transferred US$8 million to Magellan; (iii) advising in late March 2006 that Magellan had received a higher third party offer for its shares; (iv) stating Magellan had received US$10 million from BDW by [page516] April 5, 2006; (v) continuing that deceit through the period until May 16, 2006; and (vi) continuing misrepresentations between May 23 and June 20, 2006 that all was well with the SibinTek acquisition.

[177] Although Shtaif broadly submits the trial judge erred in finding him liable, he does not point to any palpable and overriding error of fact in the trial judge's deceit findings. In fact, at the hearing of the appeal, Shtaif's counsel stated he was not challenging the trial judge's findings of fact. In any event, the trial judge's reasons analyzed each of those allegations of deceit, and ample evidence supported her findings of liability.

[178] That conclusion is sufficient to dismiss Shtaif's appeal of that portion of the judgment awarding damages against him of US$8.27 million for Midland's pre-June 21, 2006 losses.

[179] Shtaif, however, raises three additional grounds of appeal in respect of other findings of liability for his pre-June 21, 2006 conduct.

[180] First, he submits the trial judge erred in finding him liable in deceit for a May 2006 statement about the worth of Reef. As with Roberts, that ground of appeal raises issues similar to those concerning the trial judge's findings of deceit against both Shtaif and Roberts for post-June 21, 2006 statements. I will deal with all the statements together in Part VIII of these reasons.

[181] Shtaif also argues the trial judge erred in finding him liable for (i) breach of fiduciary duty and (ii) unlawful conduct conspiracy.

Liability for breach of fiduciary duty

[182] The trial judge found Shtaif breached his fiduciary duty as a director to Magellan by failing to disclose to the company's board that (i) he owned 12 million BDW shares, (ii) Magellan's share price was being manipulated and (iii) the risks to the SibinTek treasury notes. Her findings of liability based on Shtaif's breaches of fiduciary duty to Magellan suffer from the same legal error as that made in regard to Roberts' breach of fiduciary duty -- Midland was not the beneficiary of the duty and could not recover for its breach. However, the errors have no effect on the judgment of US$8.27 million against Shtaif for his pre-June 21, 2006 conduct given the trial judge's findings against him of deceit, described in para. 176, above.

Liability for unlawful conspiracy

[183] The trial judge also found Shtaif liable to the respondents for damages in the amount of US$8.27 million on the [page517] basis of his participation in an unlawful conduct conspiracy. Shtaif challenges that conclusion, not on the ground that the trial judge erred in her findings of fact, but on the basis that the respondents failed to plead unlawful conduct conspiracy "with any precision or particularity".

[184] For several reasons, I am not persuaded by Shtaif's submission. First, the respondents' amended fresh as amended statement of claim contained lengthy and particularized allegations describing the unlawful conduct conspiracy, including Shtaif's role in it and the unlawful conduct -- deceit and violations of s. 126.1 of the *Securities Act*. Second, in his pleading Shtaif did not challenge the adequacy of the respondents' pleading of conspiracy; instead, he pleaded over and denied the allegations. Finally, Shtaif fully responded to the respondents' conspiracy allegations at trial.

Summary

[185] By way of summary, the trial judge's findings on the deceits described in para. 176, above, firmly supported granting judgment against Shtaif in the amount of US$8.27 million.

VIII. *Shtaif and Roberts: Grounds of Appeal Concerning Post-June 21, 2006 Events*

A. *Fraudulent misrepresentations*

The issue stated

[186] The trial judge found both Shtaif and Roberts liable for deceit in respect of statements made about the possible future value of Magellan, and then Koll, upon the completion of an IPO. The strategic business plan of Magellan, and then Koll, contemplated the acquisition of several oil and gas fields followed by the issuance of an IPO. Roberts, and to a lesser degree Shtaif, worked to gauge the interest of the (largely) Canadian investment banking community in such an IPO. They reported back to members of the boards, including Shnaider and Shyfrin, about the results of their discussions with investment bankers.

[187] The trial judge held that statements made by Shtaif and Roberts about the results of those discussions and the value of the Reef oil field (the "IPO-related statements") constituted deceits.

[188] First, she used statements contained in Roberts' May 16, 2006 e-mail to Magellan directors as an additional basis to find him liable for $8.27 million in damages for Midland's [page518] pre-June 21, 2006 losses. Specifically, she found, at para. 1030, statements in that e-mail amounted to deceit:

> Roberts wrote Ex. 18/Tab 120 to Shnaider, Shyfrin, Shtaif, De Freitas, and Groag, opining that as a result of his meetings with the investment bankers, Magellan would have no difficulty raising $300-$500 million from tier one and two investment banks.

[189] Second, the trial judge found that sometime in May 2006, Shtaif represented to Shyfrin that Reef was worth $250 million, although she does not identify the specific occasion on which

Shtaif made such a statement. She held that statement induced the respondents in mid-May 2006 to continue in the Magellan venture.

[190] The trial judge then relied on further statements made by Shtaif and Roberts in September 2006 and in February 16 and 18, 2007 documents as the basis for attaching liability to them for the balance of the judgment of $46,105,879.43: at paras. 1180 and 1186.

[191] In respect of the September 2006 discussions with the investment bankers, the trial judge did not identify specific statements made by Shtaif or Roberts. Instead, she referred to comments contained in a presentation prepared by one of the investment bankers, CIBC, which subsequently were summarized in the minutes of the Koll September 30, 2006 board meeting.

[192] The trial judge found liability in deceit for statements in certain documents prepared by Roberts and Shtaif in mid-February 2007, even though by that time Midland had advanced all funds used to acquire oil properties.

[193] Roberts circulated a February 16, 2007 memo to the Koll board with his "recommendations for a fair resolution" of the shareholders' "current impasse". The memo stated, in part, that he had "prepared a valuation based on an *assumption* that [Koll] will have a net worth of $600,000,000 at the IPO and we will raise $200,000,000 at that time . . . Obviously, *this analysis is imprecise*, but it is demonstrative none-the-less of the issues we face" (emphasis added). Although the trial judge did not specifically refer to this memo in the extract from her reasons set out above, it is the only memo of Roberts "after the end of January 2007" dealing with Koll's ability to raise financing.

[194] On his part, in mid-February Shtaif circulated some estimates of Reef's value, drawing on information contained in the Miller and Lents report, which Shnaider had received.

[195] Shtaif and Roberts submit the trial judge erred in finding them liable in deceit for the IPO-related statements because [page519] the respondents never pleaded or argued at trial that such statements amounted to fraudulent misrepresentations.

[196] The respondents acknowledge that the trial judge may have partly based her liability on factual findings that were not pled. However, in their factum they submit:

> The findings which the Appellants challenge arose directly from the pleadings, from the evidence led at trial (in many cases by the Appellants), and from the parties' closing submissions. The Appellants had adequate notice of the theories of liability that grounded the trial judge's decision and fully engaged with those theories. They knew the case they had to meet and there was no unfairness.

Analysis

[197] I would accept the submissions of Shtaif and Roberts that the trial judge erred in finding liability against them for the IPO-related statements, for several reasons.

[198] First, precision and particularity are necessary when pleading fraud. Rule 25.06(8) of the Rules of Civil Procedure requires any pleading of fraud or misrepresentation to contain "full particulars". In *Hamilton v. 1214125 Ontario Ltd.*, [2009] O.J. No. 3958, 2009 ONCA 684, 84 R.P.R. (4th) 25, this court identified, at para. 35, the necessary elements for a plea of deceit:

> The pleading, even of innocent misrepresentation, must set out with careful particularity the elements of the misrepresentation relied upon, that is:
>
> 1. the alleged misrepresentation itself,
> 2. when, where, how, by whom and to whom it was made,
> 3. its falsity,
> 4. the inducement,
> 5. the intention that the plaintiff should rely upon it,
> 6. the alteration by the plaintiff of his or her position relying on the misrepresentation,
> 7. the resulting loss or damage to the plaintiff.
>
> Of course, if deceit is alleged, then there must also be an allegation that the defendant knew of the falsity of his statement. . . . Each of the defendants must know the case that it has to meet.

[199] The respondents did not plead any of the IPO-related statements as part of their narrative of events, let alone as conduct supporting allegations of fraudulent misrepresentation.

[200] Second, the evidence led at trial cannot be read as clearly disclosing to Shtaif and Roberts that the respondents were alleging the IPO-related statements constituted deceits: [page520]

- In their evidence at trial, neither Shnaider nor Shyfrin identified any of those statements as ones that misled
- them.

- Shnaider's and Shtaif's testimony suggests they did not believe Roberts' statement in his May 16, 2006 e-
- mail that they could raise $300 to $500 million on an IPO. Shnaider stated: "I didn't believe it's going to be such a large amount of money, but I believed that we will be able to raise probably a hundred million, 150 million as a first round." Shyfrin testified he did not pay much attention to the e-mail "because company which has no assets, no assets at that time, just a pipeline but no real assets, how it go public?"

- There was evidence that at least one of the investment bankers Roberts met in May 2006, Mr. Mark
- Maybank of Canaccord, was excited about the venture. Maybank testified that his colleagues left their meeting with Shtaif and Roberts "with a level of enthusiasm and a level of excitement. We liked the story, we liked the people that were involved, and we were keen to try to secure the business for Canaccord".

- Shnaider testified he attended the September 2006 meetings with investment bankers on which Roberts
- later reported to the Koll board, and described the meetings as "basically a beauty parade that was prepared for us by the investment bankers". They were "basically introducing themselves". Shnaider stated:

> But you know, we understood that investment bankers, in order for them to permit anything, they have to do due diligence on the company, they have to do due diligence on assets of the company. *And it was way too premature at that time to do anything.*

(Emphasis added)

- Maybank confirmed that by the time of the September 2006 meetings, Canaccord was "extremely keen" on
- acting as underwriter for a Koll IPO.

- In respect of the January/February 2007 statements identified by the trial judge, in particular Roberts' memo
- of February 16, 2007, Shnaider testified he did not understand much about the value of the Reef property: "I understood that the company may be worth over a hundred million dollars, but there is also I understood that we'll need to invest considerable amount of money in order to get the oil out from the ground to market". [page521]

- Finally, in the trial cross-examinations of Roberts and Shtaif, there were no clear allegations that statements
- about the range of a possible IPO value for Magellan, and then Koll, amounted to fraudulent misrepresentations.

[201] Third, in their written closings, the respondents specifically identified three statements they alleged constituted fraudulent misrepresentations: (i) BDW had invested money in Magellan; (ii) the true identity of "Howard"; and (iii) the status of the SibinTek treasury notes. The three IPO-related statements found by the trial judge to constitute deceits were not identified by the respondents as such in their written closing. The substance of their oral closing submissions tracked those of their written submissions.

[202] Finally, closing submissions at trial concluded in June 2013. The respondents obtained leave to amend their statement of claim thereafter. However, they did not amend their claim to plead that any of the IPO-related statements amounted to fraudulent misrepresentations.

[203] Given those circumstances, it was not open to the trial judge to find that any of the IPO-related statements amounted to fraudulent misrepresentations for which Shtaif and Roberts were liable. The respondents did not allege they were such; therefore, it was not open to the trial judge to find they were. To so find, with respect, was an error.

[204] The trial judge recognized that the strength of the respondents' claim against Shtaif and Roberts might well be weaker in respect of the post-June 21, 2006 events concerning Koll. At paras. 1187-1188 she wrote:

> I have carefully considered the submission of all the Defendants that all of the pre-June 20 misrepresentations were known to be false after July 15 and that the Plaintiffs continued in the joint venture because they thought the business plan was a good one. Had I accepted that submission, Midland's damages against Shtaif would have been the same as those caused by Boock and De Freitas. Without further misrepresentations by Roberts and Shtaif after July 15, 2006, about the value of Reef, and the views of the investment bankers, and Koll's prospects on the IPO, I would have seriously questioned the Plaintiffs' assertion that Midland was justified in continuing to inject into Koll the balance of the $50 million, in order to mitigate their earlier damages.
>
> Should a higher court find that I should have accepted this submission, I note that by July 15, Midland had advanced a further $18.5 million to purchase Reef. By December 2006 it had

advanced another $9.5 million to purchase Invenskoye. As at March 1, 2007, $41,900,000 had been expended on Koll.

[205] The trial judge's error in finding any liability in respect of the IPO-related statements does not affect her findings of [page522] liability of US$8.27 million against both Shtaif and Roberts for their pre-June 21, 2006 conduct. However, as I indicated, in para. 102, above, the trial judge should not have awarded Midland damages for advances made after June 21, 2006. Her finding of liability against those appellants for post-June 21, 2006 Midland advances rested on her conclusion that the IPO-related statements constituted deceits. Since I have found she erred in so concluding, the balance of the judgments against Shtaif and Roberts for post-June 21, 2006 conduct must be set aside, save for their liability in respect of the Magellan promissory notes.

B. *The Magellan promissory notes*

The issue stated

[206] As described earlier, on June 21, 2006, before he resigned as Magellan's CEO, Shtaif signed Magellan promissory notes in favour of himself (over $1.28 million) and Roberts (US$44,796). Shnaider and Shyfrin were not told about these notes. Notwithstanding that under the settlement agreement all remaining Magellan cash was to be returned to Midland, Roberts subsequently located Magellan funds in Faskens' trust account and the TD Bank. He commenced lawsuits on the notes, secured Boock/Krakowsky/Howard's co-operation to deceive the court to obtain consent judgments, and then garnished the trust and bank accounts to satisfy the judgments in favour of Shtaif and himself.

[207] The trial judge found Shtaif and Roberts liable for wrongful conduct conspiracy for their seizure of those Magellan funds and gave judgment against them in the amount of $100,482.02 and $39,570.66, respectively.

[208] Shtaif does not seriously challenge this finding on appeal, limiting his submissions to observing the respondents had pleaded misappropriation, not conspiracy, in respect of the garnished funds. On his part, Roberts argues (i) the respondents' pleading of conspiracy was too vague; (ii) Midland was not entitled to the return of the funds, in any event; and (iii) Roberts was lawfully entitled to the funds as reimbursement for pre-June 21, 2006 expenses.

[209] The respondents concede they pled misappropriation, not conspiracy. However, they point out that much of the evidence about a conspiracy only came to light at trial because Roberts failed to produce his complete files on the issue before trial. They submit Shtaif's and Roberts' use of the Magellan promissory notes to obtain the moneys in the two accounts was a live issue at trial. [page523]

Analysis

[210] I would not give effect to this ground of appeal. Shtaif and Roberts fully responded to the issue at trial, and the trial judge granted the respondents leave to amend their pleading after closing submissions to advance their claim to recover the Magellan funds in the Faskens and TD accounts. There was no unfairness in the trial judge ultimately grounding liability in conspiracy.

[211] As to the remainder of Roberts' submission, the trial judge dealt fully with the issues at paras. 1063-1069 of her reasons. At para. 1063, she stated:

> The evidence is clear that in 2007, Roberts and Shtaif recovered money from Magellan using the secured demand promissory notes dated June 23, 2006 they had given themselves on June 21, 2006. They did not tell Shnaider and Shyfrin that they knew there were funds to Magellan's credit at Fasken's and the TD Bank, that they had given themselves the notes, that they were suing Magellan on those notes and taking other steps to collect on them.

The trial judge went on to conclude that (i) Shtaif and Roberts acted in concert; (ii) their conduct was unlawful; (iii) their conduct was directed toward the respondents; (iv) injury was likely; and (v) injury was caused.

[212] Ample evidence supported those findings. There is no basis for appellate intervention.

IX. *Failure of the Respondents to Mitigate their Damages*

[213] Shtaif and Roberts also submit the trial judge erred in finding the respondents acted reasonably to mitigate their damages.

[214] I am not persuaded by the appellants' arguments. The trial judge made two key findings on the mitigation issue: (i) the appellants lacked the financial wherewithal to buy out the respondents' position in Koll; and (ii) the respondents acted reasonably in their efforts to secure the ultimate sale of the Reef property. Again, ample evidence supported both findings, and the appellants have not identified a palpable and overriding error that would permit appellate intervention.

X. *Roberts' Counterclaim*

[215] The trial judge dismissed Roberts' counterclaim seeking damages for the loss in value of his Koll shares based on the terms of the June 21, 2006 reorganization agreement and for breach of an employment contract with Koll. Roberts appeals both findings. [page524]

[216] His submissions on appeal simply repeat those he advanced at trial. In her reasons, the trial judge dealt at length with both of Roberts' submissions. She made extensive findings of fact, many based on credibility assessments. Roberts has not demonstrated the trial judge committed any palpable and overriding error in reaching her conclusions. I therefore would dismiss his appeal in respect of his counterclaim.

XI. *Disposition*

[217] By way of summary, I would dismiss (i) Bokserman's appeal; (ii) Shtaif and Roberts' appeal in respect of the trial judge's finding of liability in the amount of US$8.27 million for pre-June 21, 2006 conduct; and (iii) Roberts' appeal of the dismissal of his counterclaim.

[218] I would allow the appeals of Shtaif and Roberts of the findings of liability in respect of their post-June 21, 2006 conduct, save and except for the liability in respect of their recoveries under the Magellan promissory notes. Consequently, I would vary para. 3 of the judgment concerning Roberts by substituting the amount of US$8,309,570.66 (US$8.27 million +

$39,570.66), and vary para. 4 of the judgment concerning Shtaif by substituting the amount of US$8,370,482.02 (US$8.27 million + $100,482.02).

[219] If the parties are not able to agree on the costs of the appeal, any party seeking costs shall file brief written submissions, including a bill of costs, no later than May 5, 2017. Any brief responding submissions shall be filed by May 19, 2017.

[220] One final observation. The trial judge devoted a considerable amount of time to inserting transcript references in her reasons for much of the evidence she reviewed. Such references can greatly facilitate appellate review. Unfortunately, the pagination of many of the transcripts filed by the parties on this appeal did not replicate the pagination used by the trial judge in her reasons. As a result, the benefit of her effort was lost. Where a trial judge undertakes including such detailed references in her reasons, appeal counsel must ensure the appeal transcripts employ the same pagination.

Appeal from judgment for plaintiffs allowed in part; appeal from dismissal of counterclaim dismissed.

[page525]

Notes

1 The operators of a "pump and dump" scheme artificially raise, or "pump" up, the price of stock in a company through misleading statements to other investors, and then sell, or "dump", their shares in the company when the stock reaches a higher price.

End of Document