

THE GR COURT DOCKET

September 20, 2018

The Unforgiving Forgivable Loan

By Stephen Thiele

In the investment industry, dealers are always looking to grow the value of investments under their management. They do this in a variety of ways, including hiring advisers with large customer bases away from other dealers under the expectation that the customers will remain loyal to the adviser.

To make a potential workplace change appealing to an adviser, a recruiting dealer will often provide a significant upfront payment to the adviser based on the value of assets under the adviser's management. The upfront payment will generally be structured as a forgivable loan.

Some advisers view the forgivable loan like a bonus, never expecting that any portion will need to be repaid to the dealer. However when the relationship between a dealer and an adviser sours, the reality that the "bonus" is nothing more than a "loan" can be unforgiving.

In the recent case of *Raymond James Ltd. v. Noronha*¹, , the Honourable Justice Perell was required on a summary

judgment motion to determine, among other issues, the enforceability of a forgivable loan against an adviser whose relationship with a dealer was terminated a couple of years after it started.

His Honour's decision reconfirms that the forgivable loan provision is a matter of contract and is enforceable. In this case, the dealer was awarded judgment of nearly \$300,000.

Relevant Facts

The adviser worked for Dundee Wealth Management when he was approached to transfer his book of business to the plaintiff dealer. The adviser had earned over \$1 million in commissions a year and managed approximately \$100 million of client assets.

Therefore, he likely appeared to the dealer to be a great prospect.

To make the transition to the dealer easier to accept, the dealer agreed to provide the adviser with an \$880,000 forgivable loan that would be paid to him soon after joining.

Founded in the 1920s, Gardiner Roberts LLP has grown to become a strategically placed mid-sized business law firm with a diverse client base which includes two of Canada's largest banks, several medium to large-sized municipalities, agencies, boards and commissions and other government entities, high tech and software companies, real estate developers, lenders and investors.

A number of our lawyers have enjoyed in-house corporate positions and been appointed as board members of tribunals or as judges.

Gavin Tighe
Partner
416.865.6664
gjtighe@grllp.com

Stephen Thiele
Partner
416.865.6651
sthiele@grllp.com

Scott Gfeller
Partner
416.865.4018
sgfeller@grllp.com

Under a written Agency Agreement entered into between the dealer and the adviser, the dealer agreed that 1/7th of the principal amount of the loan would be forgivable on each anniversary of the initial advance until the loan was fully forgiven on the seventh anniversary of the advance. The forgivable nature of the loan was subject to the condition that the adviser fulfill all requirements of the Agency Agreement and that he not be in default of the agreement.

The Agency Agreement included a termination provision and expressly stated that if the agreement was terminated, the outstanding and unforgivable balance of the loan would be immediately due and payable to the dealer. The agreement would be terminated if the adviser resigned, with or without notice, the dealer terminated the agreement, with or without cause or the adviser breached the agreement.

The adviser acknowledged that by signing the Agency Agreement, he understood that he would be required to comply with all applicable laws and the dealer's compliance manuals. He also acknowledged that he was governed by and was required to adhere to the rules of the Investment Industry Regulatory Organization of Canada ("**IIROC**").

Licensing by IIROC is a statutory requirement for investment dealers to trade in securities.

Two years into the relationship, the dealer received information that the adviser was trading in off-book investments and taking secret commissions.

The dealer investigated and found that the adviser was using his personal email address to

carry on business. This activity was unauthorized and contravened the dealer's Compliance Manual and policies relating to the use of its computer systems.

When interviewed, the adviser admitted to off-book investments but did not disclose details.

In the circumstances, the dealer felt it had no alternative but to terminate the Agency Agreement.

Subsequently the adviser informed the dealer that he was resigning, and, in turn, the dealer notified IIROC that the adviser had been terminated as a sales agent.

Despite the break down in their relationship, the dealer facilitated the transition of the adviser's clients to a new firm and in the months that followed the termination and resignation substantially all of the adviser's clients followed him to his new firm.

Subsequently while the dealer claimed that the adviser owed it money in connection with the forgivable loan, IIROC conducted its own investigation into the adviser's activities.

After the dealer demanded repayment of over \$275,000 from the adviser and the adviser refused to pay, the dealer decided to sue.

At the same time, IIROC issued a Notice of Hearing against the adviser alleging that the adviser had:

- (a) engaged in business conduct or practice that was unbecoming or detrimental to the public interest by recommending and facilitating investments to clients that were



- conducted off the books and records and without the dealer's consent;
- (b) accepted, directly or indirectly, remuneration from persons other than the dealer through his spouse for securities related matters.
- (c) failed to disclose to the dealer and to his clients a conflict of interest; and
- (d) engaged in business conduct or practice unbecoming or detrimental to the public interest by deleting email records.

Ultimately in the adviser's voluntary absence from a discipline hearing, IIROC found that the adviser had contravened its membership rules, and, among other things, ordered that the adviser be permanently barred from registering with IIROC in any capacity.

In defending the dealer's action for recovery of outstanding loan amounts, the adviser alleged that the agreement had been terminated in bad faith. He also counterclaimed for wrongful dismissal. Throughout his defence and counterclaim, the adviser contended that the dealer terminated the Agency Agreement for the sole purpose of appropriating his book of business. This argument was made in defence of the dealer's motion for summary judgment.

Decision of the Court

Justice Perell found that the dealer's action to recover the loan was a straightforward matter of contract.

Under the Agency Agreement, if an act of default occurred before the full forgiveness of the loan had occurred, the then outstanding balance of the loans, costs and all monies owing by the adviser to the dealer and all liabilities of the adviser became immediately due and

payable and constituted a debt due and owing to the dealer by the adviser. An act of default had occurred and therefore the dealer was entitled to recover the outstanding debt.

The adviser's allegation of bad faith, which contended that the dealer terminated the agreement only to appropriate his book of business, lacked merit because there was no appropriation of his book of business.

The adviser lost his book of business because he was banned for life by IIROC from being an investment dealer.

Justice Perell also dismissed the adviser's counterclaim for wrongful dismissal.

With and without regard to IIROC's findings, the adviser simply was unable to make out a case for wrongful termination or that the dealer had misappropriated his book of business.

The IIROC proceeding, indeed, confirmed the dealer's grounds for terminating the agreement.

Representation by Gardiner Roberts LLP

The dealer was represented in this action by Gavin Tighe, partner and certified specialist in litigation.

Gavin was assisted in the action throughout by senior litigation associate, Scott Gfeller.

Stephen Thiele, partner and Director of Legal Research for Gardiner Roberts LLP, assisted in the preparation of the written legal argument filed in support of the summary judgment motion.

(This newsletter is provided for educational purposes only. It is not intended to be and should not be relied upon in any manner whatsoever as legal advice, and it does not necessarily represent the views of Gardiner Roberts LLP.)