IN THE SUPREME COURT OF BRITISH COLUMBIA

Citation: ***Sunray v. Strata Corp. BCS226 et al,***
2005 BCSC 417

Date: 20050323
Docket: S82885
Registry: New Westminster

Between:

Sunray Advanced Hotel Management Inc.

Plaintiff

And

The Owners of Strata Corporation BCS226, Sandra Marie Carpenter, Pundyk Investments Inc., Russell John Clinton, Marcus John Law, Philip Charles Reynolds and Colin David Reynolds, 665618 B.C. Ltd., Hadley, Glenmac Corporation Ltd., Lowell Rob Leifso, Charles Wilfred Zandbergen and Julia Kay Stronks, Edward Peter James Chibber and Maria Luisa Chibber, Adrian Alexander Zandbergen and Colleen Jacoba Zandbergen, Myrna Lee Pudlas and Martin William Pudlas, Victor Michaluk, Dianne Jean Hatton, Verne Franklin Rosenbrant and Amanda Jane Sutherland, Simpford Holdings Inc., 646249 B.C. Ltd., Rudolf Milz and Helene Berta Milz, Glenmac Corporation Ltd., William Brian Stone and Patricia Margaret Stone, Kathleen Kobelka, Paul William Power, James Grant Hadland and Maurlice Jean Headland, Zandbergen Estate Ltd., Ocean Promenade Developments Inc., Gudrun Klara Tonskamper, Pundyk Investments Inc., Glenmac Corporation Ltd., Pie in the Sky Investments Ltd., Douglas Russell, 665318 B.C. Ltd., David Richard Jonash, 666112 B.C. Ltd., Paul Rust Architect Inc., Donald Blaine McEachern and Nancy Evelyn McEachern and Joseph Bertram Smith and Edith Joyce Smith

Defendants

And

Carbonite Development Corp., Gundhart Fleischer, Sheila Low

Defendants By Way of Counterclaim

Before: The Honourable Mr. Justice Truscott

Reasons for Judgment

Counsel for the plaintiff:	G. Grunberg
Counsel for the defendants except Ocean Promenade Developments Inc. and David Richard Jonash	D.C. Creighton
Counsel for Ocean Promenade Developments Inc. and David Richard Jonash:	M.R. Frederick
Date and Place of Trial/Hearing:	March 2, 2005 New Westminster, B.C.

[1] The plaintiff contracted with the defendant owners on February 21, 2003 to manage a hotel called Ocean Promenade All Suites Hotel in which the defendants owned units. The management agreement is entitled the Hotel Management and Rental Pool Agreement ("the Agreement").

[2] The defendant, The Owners of Strata Corporation BCS226, is a strata corporation that owns the common property in the hotel and of which the individual owners are members.

[3] The plaintiff sues the defendants for damages for breach of the Agreement by terminating its services unilaterally contrary to the terms of the Agreement.

[4] The defendants plead that they were entitled to terminate the Agreement because the plaintiff refused to allow proper access to its financial records, did not remit provincial taxes collected and misappropriated trust funds that the plaintiff held under the Agreement.

[5] The defendants counterclaim against the plaintiff as well as against the defendants by counterclaim, Carbonite Development Corp., Gundhart Fleischer and Sheila Low, alleging that the plaintiff misappropriated funds of the defendants by mismanagement of the hotel and by fraudulent diversion of funds and the defendants by counterclaim, through their involvement in the management of the hotel as agents of the plaintiff, breached fiduciary duties to the defendants by mismanagement of the hotel, by misappropriation of funds and by fraudulent diversion of funds for their own use and profit.

[6] The defendants seek injunctions against the plaintiff and the defendants by counterclaim as well as a declaration of constructive trust against the property of the plaintiff and the defendants by counterclaim. The defendants also claim punitive and/or exemplary damages.

[7] To my knowledge no defence to counterclaim has been filed as yet.

[8] On October 30, 2003, on a without notice application of the defendants, the court enjoined the plaintiff and defendants by counterclaim from dealing with any or all of their assets worldwide but gave them liberty to apply to set aside the order on 24 hours notice (the Mareva injunction).

[9] On November 12, 2003 the plaintiff and the defendants by counterclaim made such an application to set aside the Mareva injunction and at that time the court ordered that the injunction be vacated only against Carbonite, after:

a) the plaintiff produced copies of all documents in its possession or control relating to the plaintiff's management operations of the hotel by 4:00 p.m. November 18, 2003; and

b) the defendants failed to show cause on or before November 20, 2003 why the assets of the plaintiff and defendants by counterclaim should continue to be enjoined by an order of the court.

[10] On December 19, 2003 the court ordered that an accountant and representative of the defendants and of the plaintiff attended the plaintiff's premises at a mutually agreeable time to review all of the plaintiff's financial statements

(including bank statements up to October 31, 2003) and business records including access to computers and computer records.

[11] Finally, on July 16, 2004 the court ordered that the plaintiff and the defendants by counterclaim promptly ensure that they have produced all documents in their possession or control relating to the operation or peripheral operation of, the cost or expense of, the funding of, or the income of the hotel, including, without limitation, bank deposits.

[12] In that same order the court directed that the plaintiff and defendants by counterclaim provide to their then solicitor an affidavit disclosing the full value of their assets worldwide, including their location, and the affidavit be placed in a sealed envelope and held in a safekeeping place by that solicitor until further order of the court.

[13] The defendants now apply to the court for dismissal of the plaintiff's action under Rule 2(5), for failure of Mr. Fleischer and Ms Low as principals of the plaintiff to attend at the time and place appointed for their examinations-for-discovery, for failure of the plaintiff to produce and allow inspection of documents, and for failure of the plaintiff to answer interrogatories.

[14] Alternatively, if the action is not dismissed for any of these reasons, the defendant seeks orders setting peremptory dates for examinations-for-discovery and for trial, and for answering interrogatories.

[15] The defendants also seek an order for release to them of the sealed affidavit held by the former solicitor for the plaintiff and defendants by counterclaim, as well as an order for contempt of the Mareva injunction, and finally an order that the plaintiff post security for costs.

[16] I propose to deal with each of these applications in the order set out above.

[17] ***Rule 2(5)*** states:

> (5) Where a person, contrary to these rules and without lawful excuse,
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> (a) refuses or neglects to obey a subpoena or to attend at the time and place appointed for his or her examination for discovery,
>
> (b) refuses to be sworn or to affirm or to answer any question put to him or her,
>
> (c) refuses or neglects to produce or permit to be inspected any document or other property,
>
> (d) refuses or neglects to answer interrogatories or to make discovery of documents, or
>
> (e) refuses or neglects to attend for or submit to a medical examination
>
> then
>
> (f) where the person is the plaintiff, petitioner or a present officer of a corporate plaintiff or petitioner, or a partner in or manager of a partnership plaintiff or petitioner, the court may dismiss the proceeding, and
>
> (g) where the person is the defendant, respondent or a third party, or a present officer of a corporate defendant, respondent or third party, or a partner in or manager of a partnership defendant, respondent or third party, the court may order the proceeding to continue as if no appearance had been entered or no defence had been filed.

[am. B.C. Reg. 55/93, s. 2.]

Rule 2(6) states:

(6) Where a person, without lawful excuse, refuses or neglects to comply with a direction of the court, the court may make an order under subrule (5) (f) or (g).

Examinations-for-Discovery

[18] The defendants scheduled an examination-for-discovery of Mr. Fleischer for December 20 and 21, 2004, and of Ms Low for January 11 and 12, 2005. The appointments were served on their then solicitor on November 16, 2004. On December 1, 2004 that solicitor advised defence counsel of his decision to withdraw but his notice to withdraw was not filed until December 9, 2004. Meanwhile defence counsel confirmed his intention to go ahead on the scheduled dates.

[19] On December 15, 2004 defence counsel was advised by Mr. Grundberg that he had been asked to represent the plaintiff and defendants by counterclaim but he had not yet received the file from their previous solicitor and he was scheduled himself to be out of the country at the time of the examinations. He requested an adjournment until early in 2005 and indicated that Mr. Fleischer and Ms Low would not be attending at the scheduled times.

[20] Defence counsel in turn advised Mr. Grundberg on December 15th that he viewed this as another tactical delay by the plaintiff and defendants by counterclaim and that he intended to proceed to mark his appointments for Mr. Fleischer and Ms Low if they did not attend on the scheduled dates for examinations. They did not

attend and the defendants now bring on this application to dismiss the plaintiff's action by reason of their non-attendance.

[21] Ms Low says that she did not attend her scheduled examination because she was told by previous counsel that the defendants had not made complete disclosure of their documents and because Mr. Grundberg would not accept her retainer until he had a complete file from the former solicitor. Accordingly, without a lawyer she and Mr. Fleischer did not wish to attend their examinations but they had no difficulty in attending once Mr. Grundberg had the files, all relevant documents had been disclosed and he was in a position to attend with them.

[22] There has been no trial date arranged for this action. Defence counsel puts the blame on the plaintiff but it is equally available for the defendants to set the action down for trial, particularly as they have a counterclaim in existence. I decline to set a peremptory date myself.

[23] Mr. Grundberg has offered to arrange discoveries of his clients once he gets the files from their former solicitor.

[24] I think the plaintiff should be given the chance to retain legal representation before having to attend their examinations. I am not prepared to dismiss this action for failure of Mr. Fleischer and Ms Low to attend their examinations the first time they were scheduled.

[25] If the plaintiff and defendants by counterclaim do not retain Mr. Grundberg on the record or do not retain other counsel within the next month so that their

examinations can be arranged, defence counsel at that time will be at liberty to set down their examinations unilaterally and proceed.

[26] On the somewhat related issue of service on the plaintiff and defendants by counterclaim, I point out that ***Rule 4*** covers the requirements. In addition the plaintiff's former solicitor filed a notice of withdrawal under form 12A. If no notice of change of solicitor or notice of intention to act in person has been filed by the plaintiff and defendants by counterclaim, then according to ***Rule 16(9)*** the last known address of the party becomes the address for delivery as indicated in form 12A.

[27] This application for dismissal for failure of Mr. Fleischer and Ms Low to attend their examinations as scheduled, is dismissed.

Failure to Disclose Documents

[28] The order of the court of December 19, 2003 required an accountant and representative of the defendants and of the plaintiff to attend at the plaintiff's premises to review all of the plaintiff's financial and business records including access to computers and computer records.

[29] Such an attendance did take place on January 23, 2004. However, the evidence is in conflict as to whether the plaintiff produced all of its financial and business records as required, at that time.

[30] This issue came before the court again on July 16, 2004 before Mr. Justice Crawford. Before him at that time were competing affidavits of Mr. Stone and Mr.

Gardiner, for the defendants, and Ms Low and Ms Lu for the plaintiffs and defendants by counterclaim.

[31] Mr. Justice Crawford declined to deal with the applications for dismissal of the action and contempt for want of disclosure alleged by the defendants and said that he was dealing with the need to ensure, as promptly as possible, that all the documents of the hotel operation that relate to the income of the hotel, all bank deposits, all documents relating to any peripheral operation and costing of the operation, all documents regarding the expenses of the hotel operation, any documents regarding funding be produced and that there must be an order allowing the plaintiffs to trace the revenues received by Sunray.

[32] His reasons were translated into a formal order that "the plaintiff and the defendants by counterclaim promptly ensure that they have produced all documents in their possession or control relating to the operation or peripheral operation of, the cost or expense of, the funding of or the income of the Ocean Promenade All Suites Hotel, including, without limitation, bank deposits". A tracing order was also made with respect to bank records.

[33] Since the order of July 16, 2004, Mr. Gardiner has deposed in another affidavit of February 11, 2005 that the documents that the plaintiff and defendants by counterclaim should have produced are still missing. In answer, Ms Low has deposed in an affidavit of February 21, 2005 that to her knowledge all relevant documents have been produced through their former solicitor and a proper list of documents should have been provided to the defendants. She also says that for

any missing banking documents she has been informed by her former solicitor he had given written authority to the defendants' solicitor to get these documents directly from the relevant institutions.

[34] I do not consider that I have sufficient evidence to conclude whether the plaintiff has satisfied the order of Mr. Justice Crawford to ensure full production.

[35] The defendants' application to dismiss the claim for failure to produce or permit to be inspected any document or other property is dismissed.

[36] I point out that the provisions of ***Rule 26*** dealing with discovery and inspection of documents do allow for applications that require a party to swear an affidavit verifying a list already produced, or require a party to deliver an affidavit dealing with specific documents. If Mr. Gardiner says that certain documents are still missing the defendant might consider these sorts of applications first.

Interrogatories

[37] The defendants served interrogatories on the plaintiff and defendants by counterclaim, for answering by their representatives Ms Low and Mr. Fleischer, on October 29, 2004.

[38] On December 1, 2004 the then solicitor for the plaintiff and defendants by counterclaim replied by letter that the questions posed, in his opinion, did not relate to any of the matters raised in the statement of claim or defence.

[39] Counsel for the defendants takes the position that the interrogatories must only relate to a matter in question in the action, not necessarily confined to the statement of claim or defence, and in this case relate to the matter of whether the plaintiff or the defendants by counterclaim have violated the Mareva injunction issued by the court on October 30, 2003.

[40] In any event, he submits that the interrogatories are relevant to the pleading of misappropriation of funds because the defendant by counterclaim, Carbonite, may have funded a mortgage out of funds misappropriated from the defendants. Defence counsel points out that the Mareva injunction order itself must have been considered to be relevant to the pleadings to be issued in the first place.

[41] I agree with defence counsel on this point and I note that the Court of Appeal in ***British Columbia Lightweight Aggregate Ltd. v. Canada Cement LaFarge Ltd.*** 1997 4 B.C.L.R. 259 said that whether interrogatories relate to a matter in question in the action can only be ascertained from the pleadings and proceedings in the action as they stand when the interrogatories are issued.

[42] Counsel for the plaintiff and defendants by counterclaim submits that by law interrogatories are not to include demands for discovery of documents, demands for particulars, nor be in the nature of cross-examination.

[43] On my review of the interrogatories, numbers 1, 3 and 4 are improper because they seek particulars, numbers 3, 4 and 6 are improper because they seek documents, numbers 5 and 8 are improper because they are in the nature of cross-examination, and number 8 is also improper because it seeks an opinion of law.

[44] In my opinion interrogatory #7 is irrelevant to any issue in the action because it seeks information on the knowledge of the lawyer which is not relevant to the issue of whether the plaintiff or defendants by counterclaim violated the Mareva injunction.

[45] Only interrogatory #2 remains intact and it is my conclusion that it is unnecessary for the plaintiff and defendants by counterclaim to answer this question which can be easily answered by the defendants themselves through checking the state of title in the Land Title Office after the sale was completed.

[46] In any event, the issue canvassed by the interrogatories is the subject of the contempt application before me for which affidavits have been filed that essentially answer the substance of the interrogatories.

[47] The application to dismiss the action for failing to answer interrogatories is dismissed.

The Sealed Affidavit

[48] An affidavit of the worldwide assets of the plaintiff and defendants by counterclaim was ordered by the court on July 16, 2004, to be sealed and deposited with their then counsel until further order of the court. It is my understanding that such an affidavit was in fact sworn and deposited with that counsel.

[49] Defence counsel now seeks to have the affidavit delivered up to the defendants for comparison to the disclosure of assets to date by the plaintiff and defendants by counterclaim and because the former counsel holding the affidavit is no longer acting for the plaintiff and defendants by counterclaim.

[50] I do not consider the fact that counsel is no longer acting to be any reason to deliver up the affidavit to the defendants. That counsel has a continuing obligation to keep that affidavit until further order of the court unless he applies to be relieved of that responsibility.

[51] I do not understand that the defendants are in possession of any order of the court entitling them to know of all of the assets of the plaintiff and defendants by counterclaim worldwide, prior to any judgment. Accordingly I do not consider there to be any basis to allow the delivery of this affidavit for any comparison to any already existing knowledge of assets of the plaintiff and defendants by counterclaim.

[52] The reasons for judgment of Crawford J. of July 16, 2004 indicate that the conditions of access to the sealed affidavit might turn on how the parties complied with the orders for disclosure, subject to the discretion of the court hearing such an application for access.

[53] Since I am not satisfied that it has been established before me that the plaintiff and defendants by counterclaim have not made the necessary disclosure I am not prepared to order release of the sealed affidavit. This application is also dismissed.

Contempt of the Mareva Injunction

[54] The Mareva injunction was issued October 30, 2003. Defence counsel says that in October 2004 a mortgage owned by the defendants by counterclaim,

Carbonite, was discharged from property in Abbotsford on sale of that property and that this was a breach of that injunction order issued against it.

[55] Counsel for the plaintiff and defendants by counterclaim submits that while the mortgage was made out for a principal amount of $2.5 million, the evidence of Ms Low is that the mortgage represented security for future advances only by Carbonite which were never made, and as a consequence the mortgage secured no interest in the property.

[56] The evidence of Ms Low is uncontradicted and her credibility cannot be assessed on affidavit evidence alone. As a consequence I cannot say that Carbonite Development Corp. has violated the order of the court.

[57] Mr. Alperstein says in his letter (undated) that none of the sale proceeds were paid to Carbonite Development Corp. and I have no contrary evidence.

[58] If the mortgage in fact had no value then it was not any asset of Carbonite disposed of in violation of the court order. This application is also dismissed.

Security for Costs

[59] The defendants seek an order that the plaintiff post security for costs in the event it is ultimately unsuccessful in its claim, failing which its action should be stayed.

[60] Section 236 of the ***Business Corporation Act,*** S.B.C. 2002 Chap. 57, states:

> If a corporation is the plaintiff in a legal proceeding brought before the court, and if it appears that the corporation will be unable to pay the

> costs of the defendant if the defendant is successful in the defence, the court may require security to be given by the corporation for those costs, and may stay all legal proceedings until the security is given.

[61] The defendants rely upon the evidence of Mr. Gardiner, their forensic accountant, who says that on his review of documents he has from the plaintiff he concludes that the company is impecunious and would not be able to pay an award of costs made against it in the event it is unsuccessful in the lawsuit. He states that as at October 31, 2003 the amount in the plaintiff's account was only $187.34.

[62] The defendants also rely on evidence of Ms Higgins, a lawyer with the plaintiff's solicitor's law firm, who attaches a Determination of the Director of Employment Standards, dated February 11, 2005, that Mr. Fleischer and Ms Low and the plaintiff and a company, United Catering and Hotel Services Incorporation, owe to the director $13,101.89 for unpaid employee wages and an administrative penalty.

[63] Defence counsel also points to other evidence concerning the financial positions of the defendants by counterclaim, but they do not appear to me to be relevant to an issue of the financial position of the plaintiff.

[64] Defence counsel submits that the defendants have made out a *prima facie* case that the plaintiff will be unable or unlikely to be in a position to pay costs, if awarded to the defendants. He submits that the burden then shifts to the plaintiff to demonstrate that it has exigible assets of sufficient value to satisfy an award of costs to the defendants, or to demonstrate that the defendants lack a meritorious defence, or to show that any security ordered would visit an undue hardship on the plaintiff

thereby stifling any meritorious claim. He submits that the plaintiff has not demonstrated any of these grounds for denying an obligation to post security for costs.

[65] Plaintiff's counsel submits that Mr. Gardiner's evidence is hardly compelling that the plaintiff is impecunious and submits that the defendants have the burden to show that the plaintiff will not be able to pay costs, should its claims fail, which burden it is submitted the defendants have not met. Plaintiff's counsel also points out that Ms Low's evidence is that she does not agree that any of the parties are impecunious as alleged, and in any event says that if necessary Carbonite Development Corp. undertakes to pay any and all court costs that may be awarded against any of the parties.

[66] Mr. Gardiner, in another affidavit questions the value of the Carbonite assets listed in Ms Low's affidavit.

[67] I think the decision of the Court of Appeal in ***Kropp v. Swaneset Bay Golf Course Ltd.*** CA021446, March 12, 1997, is very helpful on this issue. In that case Finch J.A. (as he then was), writing for the court adopted the principles for security for costs as follows:

> [17] In *Keary Development v. Tarmac Construction*, [1995] 3 All E.R. 534, the English Court of Appeal considered s.726(1) of the Companies Act 1985, reviewed a number of authorities applying that provision or its predecessors, and then set out the principles which emerged from those cases. The principles are stated at pp. 539-542, and may be summarized in this way:
>
> 1. The court has a complete discretion whether to order security, and will act in light of all the relevant circumstances;

2. The possibility or probability that the plaintiff company will be deterred from pursuing its claim is not without more sufficient reason for not ordering security;

3. The court must attempt to balance injustices arising from use of security as an instrument of oppression to stifle a legitimate claim on the one hand, and use of impecuniosity as a means of putting unfair pressure on a defendant on the other;

4. The court may have regard to the merits of the action, but should avoid going into detail on the merits unless success or failure appears obvious;

5. The court can order any amount of security up to the full amount claimed, as long as the amount is more than nominal;

6. Before the court refuses to order security on the ground that it would unfairly stifle a valid claim, the court must be satisfied that, in all the circumstances, it is probable that the claim would be stifled; and

7. The lateness of the application for security is a circumstance which can properly be taken into account.

[18] In my view, those principles as more fully articulated and explained in *Keary* are a useful guide to the application of s. 229 in British Columbia. *Keary* was recently applied by the English Court of Appeal in *BC Industries v. Ball*, (19 November 1996), [1996] N.L.O.R. No. 4018 (Q.L.).

[68] In ***Kropp*** the affidavit evidence of Mr. Kropp was that he did not have the resources to deposit the amount sought by the defendants as security for costs.

[69] Finch J.A. said that Mr. Kropp "did not provide any details in his affidavit as to his own or the corporate plaintiff's lack of assets, or as to the ability of either of them to sell assets, borrow money, or otherwise raise funds sufficient to post reasonable security for costs" (¶21).

[70] In this case I conclude that the defendants have made out a *prima facie* case that the plaintiff has insufficient assets to satisfy costs through the evidence of Mr. Gardiner although I concede that his evidence is thin. That is somewhat to be expected from a defendant trying to determine the financial position of a plaintiff.

[71] I also conclude that Ms Low's affidavit is insufficient in that she provides no detail concerning her belief that the plaintiff is not impecunious.

[72] The plaintiff made no attempt to convince me of the merit of its claim and in fact it appears to be the case from the reasons for judgment of Mr. Justice Crawford that the plaintiff has intermingled funds and paid out funds to related companies.

[73] I conclude that the plaintiff should be required to post security for costs to allow it to continue with its claim.

[74] In ***Fat Mel's Restaurant Ltd. v. Canadian Northern Shield Insurance Co.***, CA015594, March 9, 1993, the principles to be applied in establishing the amount of security to be ordered was accepted as set out in the English case of ***Procon (Great Britain) Ltd. v. Provincial Building Co.*** (1984) 2 All E.R. 368, where the Court of Appeal said:

> ... the principle is this: the security should be such as the court thinks in all the circumstances of the case is just. If security is sought, as it often is, at a very early stage in the proceedings, the court ordering security will be faced with a situation in which a solicitor or his clerk has made an estimate of the costs likely in the future to be incurred; and probably the costs already incurred, or paid, will be a very small fraction of the security that the applicant is seeking. At that stage one of the features of the future of the action which is relevant is the possibility that the action may be settled, perhaps quite soon. In such a situation it may well be sensible to make an arbitrary discount of

> costs estimated as the probable future costs, but whether one-third is likely in any given case to be a sensible discount, and whether any discount at all should be made, will depend on the view of the court on consideration of all the circumstances.

[75] In ***Swaneset***, Finch J.A. viewed the matter as of the date of the defendant's application and attempted to balance the relevant considerations as they stood at that time. In this case, the action was started around October, 2003 but the defendant's application for security for costs was only filed in February, 2005.

[76] The defendants have presented a draft bill of costs in the amount of approximately $50,000 for fees, approximately $52,000 for forensic accountant costs to date and another approximately $50,000 for future forensic accounting costs through trial.

[77] At the hearing itself, defence counsel suggested in open court that his clients might give up their counterclaim if the plaintiffs gave up its claim. That proposal was immediately accepted by counsel for the plaintiff and defendants by counterclaim, but defence counsel said he could not obtain those instructions.

[78] Nevertheless, I have to question whether this case will be settled at an early stage.

[79] I consider, applying the principles set out in ***Fat Mel's***, that an order should be made for security for costs of $50,000 to be posted by the plaintiff in a form to be agreed upon between the parties, failing which they may make submissions before me. Until the posting of such security, the plaintiff's claim is stayed.

[80] Although the plaintiff and defendants by counterclaim have succeeded on most of the applications, the defendants have succeeded on their application for security for costs and I order that the costs of all applications be costs in the cause.

"J. Truscott, J."
The Honourable Mr. Justice J. Truscott