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Tim Ludwig Professional Corp v BDO Canada LLP: Extraordinary Damages Available to Expelled Partners

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Parties in a contractual relationship owe a duty of good faith to one another, requiring each party to perform their contractual obligations honestly. Partnerships are a unique relationship, given that the mutual confidence and high level of trust between parties is really the essence of a partnership. But what happens when that confidence and trust is breached?

Tim Ludwig Professional Corp v BDO Canada LLP, 2017 ONCA 292, is a good example of the expanding scope of extraordinary damages available to partners who are wrongfully expelled from a partnership. It is also a reminder that courts will look carefully at a partner's disputed exit in light of the duty of good faith implied in partnerships.

The Ontario Court of Appeal in *Tim Ludwig* found that aggravated damages can flow from a partnership's breach of such duty, where the "intangible harm" resulting from a bad faith expulsion is reasonably foreseeable.

Background

The plaintiff, Tim Ludwig was a chartered accountant. Mr. Ludwig was a partner of BDO Canada LLP ("BDO") for 22 years from 1992 until 2014. The terms of Mr. Ludwig's partnership agreement contemplated a compulsory retirement date in 2019. However, a process existed for the partnership's policy board to "request" his resignation before the compulsory retirement date. Under this process, the policy board could give notice to a partner to resign if it determined that it was not in the best interests of the partnership for the partner to remain.

In July 2014, two partners of the firm advised Mr. Ludwig that the CEO was requiring him to retire and intended to invoke the compulsory retirement process. In the meeting, Mr. Ludwig was informed that:

- He would have to retire because the firm was "over partnered" and the decision to require him to retire had nothing to do with his performance or conduct.
- The CEO had "the absolute right to require a partner to retire" and that he required Tim Ludwig to retire at the end of the year.
- The decision to require his retirement was between him or "the guy with nine kids at home".
- The non-competition clause in the partnership agreement would be invoked against him following his retirement.

Three months later, the partnership's policy board unanimously voted to request Mr. Ludwig to resign. BDO unilaterally announced Mr. Ludwig's retirement from the firm, and enforced his non-competition clause.

Decision and Appeal

Tim Ludwig brought a successful motion for summary judgment against BDO on the basis that his forced retirement was a breach of the partnership agreement. Ultimately, the motion judge found that Mr. Ludwig's expulsion was a decision of the CEO and not the policy board, and there was no evidence to conclude that it was in the best interest of the partnership to force Mr. Ludwig's retirement. The motion judge awarded the following damages:

- aggravated damages in the amount of $100,000 based on the manner in which Mr. Ludwig was expelled; and
- expectation damages in the amount of $1,233,739, based on profits that Mr. Ludwig would have received had the partnership agreement not been breached (as reinstatement was unrealistic).

The Court of Appeal considered whether BDO breached the provision of its partnership agreement requiring a unanimous determination of the policy board that it was not in the best interest of the partnership for Mr. Ludwig to remain in the partnership. The Court upheld the motion judge's decision, as well as the aggravated damages award. The Court also emphasized that the *Partnership Act* (Ontario) imported the common law rules into the analysis of a partnership agreement, and reiterated that partners owe each other a duty of utmost good faith.

Commentary

- Clarity on extraordinary damages in the partnership context: The Court of Appeal in *Tim Ludwig* provided some clarity on the motion judge's aggravated damages award, noting that intangible damages for bad faith in the manner of dismissal of employment are not "true aggravated damages", as they are not awarded for an independently actionable wrong. The Court cited the principle in *Keays*, which puts aside the distinction between "true aggravated damages" resulting from a separate cause of action, and moral damages resulting from conduct in the manner of termination.

  In light of *Keays*, and in combination with the principles of partnerships law, the Court held that damages for intangible harm are available in the partnership context on the *Hadley v. Baxendale* principle – where such harm is in the reasonable contemplation of the parties when they made their contract.

  That is, extraordinary damages can arise from breach of the employment contract, and more specifically, the employer or partnership's implied contractual obligation to act in good faith when dismissing an employee or expelling a partner.

- Proper procedure can mitigate a partnership's risk: While the relationship between partners in partnership differs in many respects from an employment relationship, the implicit duty of good faith in dismissal/expulsion applies in both relationships at common law. In light of this stringent duty, partnerships must exercise caution in the manner in which partners are expelled.

  Fair processes (e.g. allowing an opportunity to be heard) can help to mitigate a partnership's risk. Failure to properly carry out a partner expulsion can result in significant financial exposure to a partnership, and under certain circumstances, extraordinary damages – which, as *Tim Ludwig* makes clear, can be quite costly.

- Courts must use caution in awarding such damages: While the Court noted that partners owe the upmost duty of good faith to one another, it also stated that caution must be exercised when importing these rules from the employment context to the partnership context – as partners are typically not employees and are governed by separate common law principles and legislation.

  That said, where such "intangible harm" results from a bad faith expulsion, and such harm is reasonably foreseeable, aggravated damages are appropriate.