

# KEEPING CURRENT

November 15, 2022

## In-house lawyer breached fiduciary obligations by negotiating self-interested agreements

By James R.G. Cook

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Lawyers entering into business relationships with their clients should generally ensure that the clients receive meaningful independent legal advice on any agreements that benefit the lawyer. As illustrated by an Alberta Court of Appeal decision, this applies to outside and in-house counsel and even in circumstances where the client is sophisticated and not otherwise vulnerable or dependent upon the lawyer's advice: *Hudye Inc v Rosowsky*, [2022 ABCA 279 \(CanLII\)](#).

The case involved the Hudye Group, which began in 1946 as a family farming business in Saskatchewan before expanding into the oil and gas industry. The defendant lawyer's relationship with the Hudye Group commenced in 2008, when he was a junior lawyer. The lawyer's father had previously done legal work for various Hudye Group entities.

In May 2009, the Hudye Group transferred its files to the lawyer's professional law corporation on a fee-for-service basis under a written retainer agreement that provided for an hourly

billing rate of \$250. Over the next three years, the lawyer became more involved with the Hudye Group.

The Hudye Group began exploring strategies for exiting the agricultural industry by selling Canadian and US agricultural real estate and using the proceeds to acquire US multi-family residential real estate. The lawyer was involved in advising the Hudye Group on its structure and preparing draft agreements.

In 2012, the parties determined that lawyer would come "in-house". While an employment contract and offer of employment were prepared, the lawyer wanted an equity position in the business. The Hudye Group agreed that the lawyer would receive a 10% interest in a new ownership structure.

The lawyer, while still on the initial retainer agreement with the Hudye Group, negotiated and drafted several agreements, including a Hudye Group Trust Agreement, under which he became a beneficiary; a General Counsel Agreement (GCA) wherein

he became in-house counsel for the Hudye Group with an annual salary of \$150,000, and an equity position in the company; and commission agreements under which the lawyer's professional corporation would receive a commission for services rendered in connection with certain real estate and other holdings.

After becoming general counsel to the Hudye Group, the lawyer drafted a Unanimous Shareholder Agreement (USA), under which he held a beneficial interest in a newly formed U.S. company (Nutri) pursuant to his equity interest in the Hudye Group Trust.

In early 2013, the relationship began to break down as the lawyer became dissatisfied with his financial position and the Hudye Group sought to undo the existing arrangements and revert to a fee-for-service retainer. The lawyer's services were terminated completely in January 2014.

The Hudye Group subsequently sued the lawyer, claiming that he had breached his fiduciary obligations as their lawyer by demanding new terms of engagement and drafting the various agreements that benefited him without making them aware of the conflict between his interest and theirs, advising them on the fairness of the transactions, and not insisting that they obtain independent legal advice before proceeding with the agreements.

The Hudye Group's claims were dismissed at trial. In the trial judge's view, the Hudye Group was sophisticated and experienced, and it was not vulnerable or dependent on the lawyer except in the specific circumstances where he was giving them legal advice. The negotiation and implementation of the GCA and commission agreements, which reflected the business aspect of the parties' relationship, did not engage fiduciary obligations on the lawyer's part. While the lawyer did have a fiduciary duty to advise the

Hudye Group to obtain independent legal advice with respect to the Hudye Group Trust and USA, he had discharged that duty.

The Alberta Court of Appeal found that the trial judge had adopted an unduly restrictive view of when a fiduciary duty arises. To characterize the GCA and the commission agreements as a simple negotiation between arms-length parties ignored the obligations owed by the lawyer to his client. The Court referred to the majority decision of the Supreme Court of Canada decision in *Hodgkinson v Simms*, [1994 CanLII 70 \(SCC\)](#) at paragraphs [40 and 42](#):

In sharp contrast to arm's length commercial relationships, which are characterized by self-interest, the essence of professional advisory relationships is precisely trust, confidence, and independence. ...

Courts exercising equitable jurisdiction have repeatedly affirmed that clients in a professional advisory relationship have a right to expect that their professional advisors will act in their best interests, to the exclusion of all other interests, unless the contrary is disclosed.

The Court of Appeal found that it was an error in law to conclude, on the basis that the client was sophisticated and not particularly vulnerable, that a lawyer owed no fiduciary duties to that client when negotiating agreements that would directly benefit the lawyer. Rather, the lawyer owed fiduciary duties to the Hudye Group in the negotiation and drafting of the agreements which granted him an equity stake in his client's business and other benefits. At a minimum, those obligations required the lawyer to recommend to his client that it obtain independent legal advice. In the absence of such advice, the lawyer had a heavy onus to establish

that the transactions were fair and just and in no way disadvantageous to his client.

At trial, however, the lawyer adduced no evidence that the transactions were fair and just or reasonable. The only mention of referring the client for independent legal advice concerning the Hudye Group Trust appeared in an email from the lawyer to members of the Hudye Group, attaching a draft of the Hudye Group Trust, in which he stated: "I am required by the Code of Conduct to tell you to seek independent legal advice". The evidence of the Hudye Group was that the recipients of the email did not take note of this paragraph and there was no other discussion regarding independent legal advice.

The Court of Appeal concluded that the email note was insufficient to discharge the fiduciary obligations that arose from the lawyer's drafting of the Hudye Group Trust, under which he obtained a 10% equity stake in his client's family-run business. Something more than a rather off-hand mention of independent legal advice was required to discharge the lawyer's fiduciary obligations. At a minimum, the lawyer had to explain his conflict of interest in drafting the agreements and recommend that his client obtain independent legal representation. In the circumstances, these obligations were breached.

As a remedy, the Court of Appeal ordered that the GCA and the commission agreements be set aside and that the lawyers' corporation disgorge the commission payments received of \$145,634.36 plus pre-judgment interest. The lawyer's interests in the Hudye Group Trust and USA were set aside.

The Court of Appeal accepted the lawyer's argument that if the agreements were set aside he should be entitled to be compensated for his work for the Hudye Group on a *quantum meruit* basis for the services rendered. As a result, he

was ordered to be compensated on an hourly rate basis for the legal work he performed for the Hudye Group from June 1, 2012, until the cessation of his legal services based upon the rate of \$250 per hour plus GST as stipulated in the initial retainer agreement, subject to a setoff for the salary paid to him under the terms of the GCA.

The decision shows the issues that a lawyer may face when attempting to uphold business agreements with a client. Had the lawyer ensured that his client received independent legal advice on the various agreements, the court may well have determined that there was no breach of fiduciary duty. Absent such independent advice, the lawyer will be in a difficult position if called upon to show that the transactions were fair and reasonable for the client.

### **Contact us**

If you have a litigation matter and are in need of legal advice, please do not hesitate to contact [James Cook](mailto:jcook@grllp.com), at 416.865.6628 or [jcook@grllp.com](mailto:jcook@grllp.com).

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