NOVA SCOTIA COURT OF APPEAL
Citation: ***Bardsley v. Stewart***, 2014 NSCA 106

Date: 20141126
Docket: CA 420522
Registry: Halifax

Between:

James Bardsley, of Halifax, in the County of Halifax, Province of Nova Scotia; Palmer Refrigeration Inc., a body corporate, incorporated under the laws of the Province of Nova Scotia; and Palmer Engineering Ltd. (a.k.a. Palmer Geothermal & Associates)

Appellants

v.

David Stewart, of Dartmouth, in the County of Halifax, Province of Nova Scotia; Peter Beaini, of Bedford, in the County of Halifax, Province of Nova Scotia; and High Performance Energy Systems Inc., a body corporate, incorporated under the laws of the Province of Nova Scotia (in receivership)

Respondents

Judges:	Hamilton, Fichaud, Bryson, JJ.A.
Appeal Heard:	September 23, 2014, in Halifax, Nova Scotia
Held:	Appeal dismissed with costs reasons for judgment of Hamilton, J.A.; Fichaud and Bryson, JJ.A. concurring
Counsel:	Kent L. Noseworthy for the appellants Jasmine M. Ghosn for the respondents David Stewart and Peter Beaini Jason T. Cooke and Leon S. Tovey for the respondent Price Waterhouse Cooper Inc.

Reasons for judgment:

[1] The individual parties, James Bardsley, David Stewart and Peter Beaini, have been engaged in extensive and complex litigation for a number of years arising out of their "hopeless financial disputes" as shareholders, officers and directors of High Performance Energy Systems Inc. (High Performance), now in receivership. This appeal is from the decisions of Justice Gerald R. P. Moir, reported at 2012 NSSC 191 ("main decision"), 2012 NSSC 192 and 2013 NSSC 11 ("supplemental decision"), and the resulting orders.

[2] The 299 paragraph main decision was issued on May 10, 2012 following a nine day hearing of the omnibus application of the respondents, Mr. Stewart, Mr. Beaini and High Performance, seeking from the appellants, Mr. Bardsley, Palmer Refrigeration Inc. and Palmer Engineering Ltd., the return of assets; repayment of money; assignment of a patent application; compensation for Mr. Bardsley's breach of fiduciary duties owed to High Performance, including taking business opportunities open to High Performance; stays of multiple legal actions and execution orders; removal of Mr. Bardsley as agent, officer and director of High Performance; compensation for encouraging third parties in efforts to place High Performance in bankruptcy and an accounting, among other things. After the main decision was released, but before an order was issued, the parties sought and were given another hearing before the judge on November 6, 2012. The supplemental decision was issued following that hearing.

[3] There was voluminous material before the judge. In the main decision, he thoroughly reviewed all issues and evidence before him and made numerous findings of fact in reaching his decisions on the many issues before him. Only two issues are raised on appeal. Therefore it is not necessary to review all of the background involving the parties.

[4] The two grounds of appeal raised by the appellants concern the judge's decision with respect to (1) an application for a patent made by Mr. Bardsley and Terry Lay (the latter not being a party to the application or this appeal), under the name "Coaxial Borehole Energy Exchange System for Storing and Extracting Underground Cold" and (2) the appellants' entitlement to equitable set-off of any amount that may be determined to be owed to them by High Performance, against the amounts the judge ordered them to pay High Performance.

[5] The background necessary to understand the first ground of appeal, the patent application, is as follows.

[6] In the amended notice of application before the judge, the respondents claim:

> (4) Requiring James Bardsley, Palmer Refrigeration Inc., Palmer Engineering Ltd. (a.k.a. Palmer Geothermal & Associates) to:
>
> …
>
> c. Assign to HPES relevant patent applications with respect to the coaxial borehole cold energy storage system and other intellectual property funded by and developed by HPES;

[7] There is no dispute High Performance, incorporated in 2006, was in the business of designing, installing and maintaining systems for underground thermal energy storage and distribution of the type described in the patent application and claimed to own this technology in its contracts with its clients. Mr. Bardsley's evidence was that any rights arising from the patent application belonged to him and Mr. Lay. The respondents' evidence was that any such rights belonged to High Performance.

[8] The relief sought in paragraph 4(c) is specific - an assignment to High Performance of the patent application for the coaxial borehole system. By comparison, the relief claimed under paragraph 4(a) of the amended notice of application is general, seeking a return to High Performance of all of its assets in the possession of the appellants:

> (4) Requiring James Bardsley, Palmer Refrigeration Inc., Palmer Engineering Ltd. (a.k.a. Palmer Geothermal & Associates) to:
>
> a. Return to HPES all HPES assets in their possession, including but not limited to drill rig, Kubota machine, pipe welding and office equipment, website domain, HPES telephone number, all unused HPES cheques;

[9] In her October 20, 2010 brief relating to a preliminary motion in this proceeding, that was heard by Justice Pierre L. Muise, counsel for the respondents treated the patent application issue as part of the claim under 4(a).

[10] In his November 17, 2010 responding brief, counsel for the appellants did the same:

> 126. 3. Did James Bardsley and/or Palmer Refrigeration Inc. acquire improper possession or control of certain HPES assets such as the mobile drill rig, **intellectual property covered under a pending patent application** and funds on deposit with the company bank account? (Emphasis added)

[11] On November 24, 2010, following the hearing of the preliminary motion, Justice Muise ordered that the hearing concerning the relief sought in paragraph 4(c) be adjourned until Mr. Lay was added as a respondent and served. That was not done prior to the commencement of the hearing of the application before Justice Moir on February 28, 2011.

[12] At the commencement of the hearing before Justice Moir, it was agreed the remedy claimed in paragraph 4(c) was not before him:

> **MR. NOSEWORTHY** [counsel for the appellants]**:** I apologize again, My Lord. I probably should have raised this as well. I believe, subject to what Ms. Ghosn [counsel for the respondents] says, that there's two -- two aspects of the relief being sought that have been -- are not being sought at this time. I believe this was per the order of Justice Muise. In paragraph...4(c) deals with a patent application. And I believe, because Terry Lay is a co-applicant along with James Bardsley on that, it was decided that Mr. Lay is not a party to these proceedings, has never been served, and that that relief would be abandoned on this application, subject to what Ms. Ghosn says. That was my understanding. So my intention would be not to spend any time on asking this witness any questions about that if that's the case…
>
> … So I'm just wondering -- clarification on that, then I won't -- I won't ask the witness any questions on those aspects.
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> …
>
> **MS. GHOSN:** With respect to the first issue on the patent, we are not abandoning the request for assigning the patent to the company. There was an order that that particular issue would be stayed until Mr. Lay was served and to be dealt with separately, but by no means abandoned. That all said, I think that the patent issue is relevant to what happened at Alderney, and also around the bankruptcy issue. So there may be some relevant questions, in fact, arising out of the patent.
>
> **THE COURT:** That's up to Mr. Noseworthy in his cross, but what he should consider is that 4(c) is not before me, because it's stayed, not that it's been withdrawn. Fair enough?
>
> **MS. GHOSN:** Right. …
>
> **THE COURT:** … -- the facts associated with the patent are relevant to other claims.

MS. GHOSN: For sure. Now, there...

THE COURT: But neither are before me.

MS. GHOSN: Correct.

THE COURT: Okay. Mr. Noseworthy, any problem with that?

MR. NOSEWORTHY: No, I don't, My Lord.

[13] Without objection, and noting the relief claimed in paragraph 4(c) had been "carved out" of the issues to be decided by the judge, during the hearing Mr. Bardsley and Dr. Allan Abbass (not a party) were cross-examined about their involvement in the technology that was the subject of the patent application.

[14] In the final submissions of appellants' counsel filed June 20, 2011, he states:

> 130. It is my understanding that at an earlier procedural hearing before your Lordship, that the issue of the proprietary interest in a coaxial borehole and tricycle design patent applications was withdrawn from the relief sought on this Application in court. The evidence was that Terry Lay was a contributor and co-proponent of the patent application, #2584770. He is not and has never been a party to this proceeding. (See supplemental rebuttal affidavit of James Bardsley deposed to on February 17, 2011 at Tab K). In fact there is no affidavit of Terry Lay filed in this proceeding.

[15] In the main decision issued on May 10, 2012, the judge makes it clear he did not accept Mr. Bardsley's evidence concerning the events that gave rise to the patent application. He noted the application was made secretly after the incorporation of High Performance and that Mr. Bardsley's claim of ownership was contrary to High Performance's representations in its contracts that it was the owner and Dr. Abbass' evidence, which he accepted. He found the invention described in the patent application was not finished when High Performance was incorporated and that employees, agents and contractors of High Performance contributed to it.

[16] He concluded:

> [232] *Claim for Assignment of Patent Rights*. I refer to the discussion at para. 56 to 67. Mr. Bardsley misappropriated whatever right High Performance had to patent the Coaxial Borehole Exchange System for Storing and Extracting Underground Cold. I will grant an order for a mandatory injunction requiring Mr. Bardsley to do whatever is necessary to transfer the application to High Performance or, if it cannot be transferred, to abandon the application in favour of one to be filed by High Performance.

…

> [293] I will grant a declaration that High Performance developed the "Coaxial Borehole Exchange System for Storing and Extracting Underground Cold" that is the subject of a patent application. I will enjoin Mr. Bardsley to take all steps necessary to have High Performance recognized as the owner of the patent.

[17] At the November 6, 2012 hearing, the wording of the order relating to the patent application was discussed. The judge made it clear it was only to oblige Mr. Bardsley to take action with respect to the patent application, not Mr. Lay: "It's directly entirely at Mr. Bardsley." … "It's one thing for me to enjoin Mr. Bardsley to take all steps necessary, I'm prepared to do that, but we may find that he can't take all steps necessary. That is to say that he can't bind Mr. Lay."

[18] The order provides:

> c) It is declared that High Performance developed a patent application, or patent applications, under the name "Coaxial Borehole Energy Exchange System for Storing and Extracting Underground Cold" and it is the owner of any patent issued under such an application. James Bardsley shall take all steps necessary to have High Performance recognized as the owner of any patent issued under such an application and all steps necessary to have High Performance become the applicant if a patent is not yet issued. James Bardsley shall, if High Performance directs him to do so, cause an application for such a patent to be abandoned in favour of a new application filed, or to be filed, by High Performance.

[19] I should also indicate that, with the consent of all parties, fresh evidence was admitted which "may" indicate that the patent application has been abandoned. I use the word "may" intentionally. Patent law is a specialized area of the law. The evidence is not conclusive as to whether it would be possible to breathe new life into the application at some point.

[20] The background necessary to understand the second ground of appeal, the equitable set-off issue, is as follows.

[21] The respondents amended notice of application that was before the judge provides, among other things:

> (4) Requiring James Bardsley, Palmer Refrigeration Inc., Palmer Engineering Ltd (a.k.a. Palmer Geothermal & Associates) to:
>
> a. Return to HPES all HPES assets in their possession, including but not limited to drill rig, Kubota machine, pipe welding and office

> equipment, website domain, HPES telephone number, all unused HPES cheques;
>
> b. Return to HPES all funds improperly withdrawn from the HPES bank account, including but not limited to the $125,000 taken in June, 2009 and overpayments made to Carol Harrietha in the amount of $225,000; and any other funds to be determined
>
> …
>
> f. Compensate HPES for James Bardsley's breach of fiduciary duty to HPES, and general disregard for the best interests of the company and actively taking steps with a view to bringing about failure of HPES
>
> …
>
> h. Provide a full accounting of profits made in connection with HPES

[22] In the main decision, further to paragraph 4(a) of the amended notice of application, the judge found that Mr. Bardsley breached his fiduciary duty to High Performance (paragraph 207) when he purchased a drill rig in his own name with High Performance's money and was liable to High Performance in conversion for the drill rig (paragraph 203) and provided:

> [208] High Performance will have judgment against Mr. Bardsley for the purchase price of the drill rig, taxes paid on the purchase, and interest at three percent a year from the date of purchase.

[23] He found, further to paragraph 4(b), that Mr. Bardsley improperly withdrew $105,000 from High Performance's bank account on June 19, 2009 and ordered:

> [212] High Performance will have judgment against the respondents for $105,000 with interest at five percent a year from June 19, [2009] until the day of the judgment.

[24] He found, again further to paragraph 4(b), that the respondents had not proved that an overpayment of $225,000 had been made to Ms. Harrietha, Mr. Bardsley's common law wife who was not a party. In his reasons dealing with his dismissal of this claim, the judge refers to the affidavit of Ms. Harrietha, in which she purports to provide an accounting of the state of accounts between the parties. With respect to this claim, he concludes:

> [219] I find that nothing is owing by High Performance to Mr. Bardsley, Ms. Harrietha, or the Palmer companies. **On the other hand, the applicants have not discharged the onus they bear to prove a balance of accounts favours High Performance.** (Emphasis added)

[25] The judge also found, pursuant to paragraphs 4(f) and (h), that Mr. Bardsley breached his fiduciary duty to High Performance by taking a business opportunity open to High Performance (paragraph 241) and ordered an accounting:

> [248] In my view, an order under Rule 66 - Account is necessary and just. I would order, under Rule 66.04(3)(c), that the respondents disclose all revenue realized on the MASDAR project. That is to say, every cent paid to them regardless of expenses. I would order that a referee take the accounts by subtracting whatever expense the respondents prove is properly attributable to the revenues. High Performance is to have judgment against the respondents for the balance plus interest at three percent per year from January 31, 2010 until the date of the judgment.

[26] The judge's first sentence in paragraph 219 of his main decision, which is set out in paragraph 24 above, that High Performance did not owe anything to the appellants or Ms. Harrietha, was challenged by the appellants at the November 6th hearing. They pointed out that Ms. Harrietha had credited almost the full amount the judge ordered them to pay High Performance with respect to the drill rig and the improperly withdrawn money, against the amount her calculations showed were owing by High Performance to them. They argued that at least this amount was now owed to them by High Performance. They sought to have the amount the judge ordered them to pay High Performance set-off against the amount they say High Performance owes them.

[27] The judge agreed he made an error in stating High Performance did not owe anything to the appellants or Ms. Harrietha. He said it was not a finding he was required to make and that it did not affect the balance of his decision. His supplemental decision explains his error, corrects it, and denies equitable set-off to the appellants:

> [21] My oral decision on November 6, 2012 was:
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> …
>
> I did not appreciate that $103,133 and $89,570 had been credited in the accounting. For that reason, my finding that nothing is owing by High Performance to Mr. Bardsley, Ms. Harrietha, or the Palmer companies is in error. **There may well be some $200,000 owing.** Mr. Noseworthy suggests that Mr. Bardsley should not be ordered to pay these sums twice. They have already been paid he says, in the sense of credited against debt.
>
> I agree with Ms. Ghosn that the respondents cannot use the accounting to take a preference. **The effect of the submission for the respondents is that damages for misappropriation of funds and damages for**

> **conversion of property are set off against debt.** No case was made for legal set off. Indeed, none could possibly have been made. **It would be inequitable for Mr. Bardsley, Ms. Harrietha, and the Bardsley companies to set off debt against assets of High Performance to the disadvantage of the other general creditors.** There is no case, therefore, for equitable set off.
>
> **I correct my finding, but the only result is that there respondent and Ms. Harrietha are free to attempt to rank as unsecured creditors.**

[22] This prompted the applicants to ask me to take another look at the response Mr. Stewart attempted to make to Ms. Harrietha's accounting. I pointed out that the operative finding was the second one, that the applicants had failed to prove their claim that a balance of accounts favoured High Performance. **The correction to the first finding does not preclude a challenge to a claim made in future by Mr. Bardsley, Ms. Harrietha, or the Palmer companies.**

[23] The applicants' position on this subject was strident, and it was even suggested that I did not read the affidavit in which Mr. Stewart attempted to do his own forensic accounting. That affidavit provided, among other things, Mr. Stewart's basis for establishing an opening balance sheet, for entirely rejecting those of Ms. Harrietha's expenses that Mr. Stewart found to be unsupported by source documents, and for making numerous financial claims against Mr. Bardsley. I concluded, at para. 231 of the main decision: "Except as discussed elsewhere, I will dismiss the applicants' claim for judgment based on the state of accounts between High Performance and the respondents."

[24] One of the reasons the applicants failed to prove the state of accounts between High Performance and the respondents, **and the reason the respondents will have difficulty with any future claim, is that the directors utterly failed in their duty to set up adequate financial controls for their company.** See the main decision including these paragraphs particularly: 3 to 13, 80 to 87, 102 to 103, 136, 180, 185 to 196, and 220 to 231**. …** (Emphasis added)

Issues:

[28] The two issues that I see are to be determined in this appeal are:

1. Did the judge err by improperly granting the remedy sought in paragraph 4(c) of the respondents' amended notice of application, dealing with the patent application, which was not before him?
2. Did the judge err in refusing to grant the appellants equitable set-off of any amount that may be found to be owing to them by High Performance, against the amounts the judge ordered them to pay High Performance?

Standard of Review:

[29] The appellants state that the standard of review for both issues is correctness. I disagree.

[30] With respect to the patent application issue, there is no standard of review. The issue is whether the judge's actions were procedurally fair which we decide at first instance.

[31] With respect to the equitable set-off issue, this involves a question of mixed fact and law. Accordingly, the judge's decision is owed significant deference; **Housen v. Nikolaisen**, [2002] 2 SCR 235. This Court will not interfere unless the judge made a palpable and overriding error or an error on an extractable issue of law.

Analysis:

First ground of appeal

[32] The first issue is whether the judge erred by improperly granting the remedy sought in paragraph 4(c) of the respondents' amended notice of application, dealing with the patent application, which was not before him.

[33] The relief sought in paragraph 4(c) is very specific, the assignment of the patent application to High Performance. The general relief sought under paragraph 4(a), the return by the appellants to High Performance of all of High Performance's assets, remained before him.

[34] The specific relief sought in paragraph 4(c) was not to be determined by the judge because Mr. Lay was named as an inventor and owner in the patent application and was not a party to the application before him.

[35] It is instructive to note that in their submissions to the court on the preliminary motion heard by Justice Muise, counsel for both parties grouped their arguments dealing with the patent application together with their arguments for a return of other assets under paragraph 4(a).

[36] During the November 6th hearing following the release of the judge's main decision, the judge made it clear he understood Mr. Lay was named as an inventor and owner in the patent application and that his decision was not intended to bind

him. He made it clear his order was only directed at requiring Mr. Bardsley to take action with respect to the patent application, to the extent he could.

[37] I am satisfied a reasonable interpretation of the order is that the remedy granted by the judge with respect to the patent application was made pursuant to paragraph 4(a), not paragraph 4(c). His discussions with counsel at the commencement of the hearing and at the November 6th hearing, together with his supplemental decision, make it clear he was cognizant of the need to avoid granting a remedy under paragraph 4(c) so as not to affect Mr. Lay's interests. His order stops short of granting the assignment remedy sought under paragraph 4(c).

[38] It is restricted to obliging Mr. Bardsley to transfer his interests to High Performance to the extent possible.

[39] Not having granted a remedy under paragraph 4(c), the procedure he followed was fair. I would dismiss this ground of appeal.

Second ground of Appeal

[40] Did the judge err in refusing to grant the appellants equitable set-off of any amount that may be found to be owing to them by High Performance, against the amount the judge ordered them to pay High Performance?

[41] The appellants agree they are not entitled to set-off at law, where the obligations between the parties must be liquidated debts and where there must be mutuality; **Holt v. Telford**, [1987] 2 SCR 193. They argue however that the judge erred in not granting them equitable set-off.

[42] The appellants argue the judge made several errors. They say he erred in finding they had not claimed, or argued during the main hearing, that High Performance owed them money and that such amount should be set-off against any amount found to be owed by them to High Performance. They say he also erred by changing his mind between the time he issued his main and supplemental decisions – arguing that in the main decision he found Ms. Harrietha's affidavit accurately reflected the state of accounts between the parties and that the accounts should be set off and then reversed himself in his supplemental decision where he found they had not proved anything was owed to them by High Performance and that if any such debt is proved subsequently, it cannot be set-off against the amount he ordered them to pay High Performance.

[43] They also argue the judge erred by considering the wrong factors in deciding whether to grant set-off. They say he was only to consider whether the claims were sufficiently "connected", not whether Mr. Bardsley had "clean hands" or whether it would cause an unfair preference in terms of the other creditors of High Performance.

No claim or argument for debt or set-off

[44] The judge noted the appellants had not made a claim in the application before him, or an argument during the main hearing, that the respondents owed them money that should be set-off against any amount he ordered them to pay High Performance. The appellants agree there was no specific pleading, that no counter-claim was filed, but they say the interplay of s. 4(b)(ii) of the **Judicature Act**, R.S.N.S., 1989, c. 240 and **Civil Procedure Rule 4.12(1)** provided the basis on which the judge could make such an order. It is not necessary to review these provisions, and the specific words used in each, to determine if they can support a claim for debt and set-off because the appellants' problem is that they never used any words that affirmatively put forward before the judge a claim for debt and set-off. There is nothing to that effect in the pleadings or elsewhere in the record.

[45] More importantly, this finding by the judge did not affect anything because he proceeded to consider the substance of their argument as if it was properly before him.

Changed mind

[46] The appellants interpret the judge's reference to Ms. Harrietha's affidavit when he denied the respondents' claim for an additional $225,000 from the appellants in his main decision, as indicating his acceptance of the accuracy of her calculations as to the state of accounts between them and High Performance and that they should be set off against each other.

[47] I disagree. The judge at no time stated that he accepted her accounting as accurate. Nor is it reasonable to infer this, as it would be contrary to the major common theme throughout his reasons; namely, that on the evidence before him, there was no way to determine with certainty the state of these accounts because of the disarray of High Performance's financial records from the start.

[48] At the beginning of his main decision the judge states the following about High Performance's financial records:

> [4] The company lacked basic financial controls. It did not regularly record accounts payable or accounts receivable. It failed to maintain a general ledger. It operated on cash and on credit extended by an investor, by Mr. Bardsley, and by persons related to him. It did not reliably record credit extended through Mr. Bardsley.
>
> [5] There was no opening balance sheet. Years after incorporation, the shareholders were arguing about the value of their initial investments and how the investments should be treated if financial statements could ever be produced.
>
> [6] There was a homemade shareholder agreement, which included usual terms but failed to address the issues specific to the business. These were issues professional advisors would uncover and cause the principals to confront had professionals been consulted. What assets and liabilities moved from the separate businesses? How were their values to be accounted? Would intellectual property resulting from work done by principals, employees, or contractors belong to the company?
>
> …
>
> [9] After a couple of years, the principals found themselves embroiled in hopeless financial disputes. They engaged in dubious tactics, never facing the essential problems of the company's flimsy legal and accounting foundation. Their major customers became exasperated with the results.

[49] The judge also refers to the state of High Performance's financial records in finding that it was this state, together with the shareholders' unwillingness to provide information to James Horwich (the accountant previously appointed by the court to prepare financial statements for High Performance), that prevented Mr. Horwich from being able to prepare anything but draft financial statements for High Performance. In his main decision the judge described the difficulties Mr. Horwich faced:

> [186] *Financial Statements*. The order also provided a remedy for a fundamental failing of the company. The directors were required to "arrange for financial statements", which were to be prepared by James Horwich, Chartered Accountant. Mr. Horwich gave evidence. I accept his affidavit evidence and his testimony.
>
> [187] Not long after the order was made, the principals signed an engagement letter prepared by Mr. Horwich. In addition to their obligations under the shareholder oppression order, they undertook to provide AC Dockrill Horwich Rossiter with "accurate and complete information necessary for us to prepare the financial statements".
>
> [188] No financial statements were produced by the accounting firm, only two sets of drafts. This is because "the company had only rudimentary business

records" and "no reliable accounting records", it did not produce all source documents Mr. Horwich required, and he "did not get full cooperation from all three of the principals".

[189] Financial recording was so primitive that the accountants had to start by creating a general ledger. The bookkeeper provided "very little": cheque stubs and a listing of accounts payable. Another provided "some form of general ledger" containing unclear dates and unexplained transactions.

[190] There was a payroll record and an attempt at financial statements for no discernible period. There were undated notes about undated payments by and to the company.

[191] There was a record of T4 slips that included amounts for withholdings but no record that withholdings were ever set aside or paid to Revenue. Apparently, HST was never remitted.

[192] I asked Mr. Horwich about the risk undertaken by a company that generates significant revenues and undertakes significant liabilities but that operates with such flimsy financial controls. He said the risks were enormous. Firstly, tax liabilities would have to be construed. Secondly, without a basic level of assurance, capital could not be raised. Thirdly, the company risks running out of money with consequential damage to the reputation of the principals, to investments made by the investors, and to the general creditors.

[193] Despite these enormous risks, despite their responsibility for the situation that caused them, and despite the shareholder oppression order, the principals failed to cooperate with Mr. Horwich. They failed to settle outstanding issues that stood in the way of his signing financial statements. They failed to reconstruct needed information.

[194] Mr. Beaini and Mr. Stewart even went so far as to excuse their duties under the engagement letter and the order by choosing to misconstrue Mr. Horwich's activity as evidence of unprofessional conduct.

[195] In view of the lack of cooperation from any principal, Mr. Horwich resigned. His firm withdrew their services effective December 31, 2009. They have not been paid.

[196] (Despite the fact that they forced Mr. Horwich to resign before he could provide any assurance, all three principals attempted to use his draft financial statements to prove various things in this proceeding. I am ignoring the drafts except for what they show Mr. Horwich went through in his attempt to provide what the shareholder oppression order required.)

[50] He later stated:

> [231] Except as discussed elsewhere, I will dismiss the applicants' claim for judgment based on the state of accounts between High Performance and the respondents.

[51] In his supplemental decision the judge expresses his doubts about the appellants ever being able to prove they are owed money by the respondents because of the state of High Performance's financial records:

> [24] One of the reasons the applicants failed to prove the state of accounts between High Performance and the respondents, and **the reason the respondents will have difficulty with any future claim**, is that the directors utterly failed in their duty to set up adequate financial controls for their company. See the main decision including these paragraphs particularly: 3 to 13, 80 to 87, 102 to 103, 136, 180, 185 to 196, and 220 to 231**.** (Emphasis added)

[52] I am satisfied from these and other findings that the judge never accepted the accuracy of Ms. Harrietha's calculations as to the state of accounts between the parties or agreed any claims would be set-off against each other, either initially or finally.

Improper considerations

[53] In refusing to grant equitable set-off during the November 6th hearing the judge reasons:

> I agree with Ms. Ghosn that the respondents cannot use the accounting to take a preference. The effect of the submission for the respondents is that damages for misappropriation of funds and damages for conversion of property are set off against debt. No case was made for legal set off. Indeed, none could possibly have been made. It would be inequitable for Mr. Bardsley, Ms. Harrietha, and the Bardsley companies to set off debt against assets of High Performance to the disadvantage of the other general creditors. There is no case, therefore, for equitable set off.

[54] As indicated, the appellants also say the judge was only to consider whether the claims were sufficiently "connected", not whether Mr. Bardsley had "clean hands" or whether it would cause an unfair preference in terms of the other creditors of High Performance.

[55] The appellants base their argument, that the judge was only entitled to consider whether there was a sufficient connection between the claims, on the reasons of the Supreme Court of Canada in **Holt**. They say in **Holt** the court

resolved the issue of equitable set-off solely on the basis of whether there was a sufficient connection, with no mention of clean hands, from which they say it can be inferred the clean hands doctrine no longer applies to equitable set-off. They say their position is supported by **Special Mines Services Inc. v. Oak Supply Inc.,** [1998] O.J. No. 3823 and **British Columbia (Attorney General) v. Malik**, 2009 BCSC 595.

[56] I disagree.

[57] In none of these cases does the court state that the doctrine of clean hands no longer applies to equitable set-off. In **Holt** the facts did not raise a question of inequitable behaviour, so it was not necessary for the court to consider the clean hands doctrine. It only had to deal with whether there was a sufficient connection between the claims. In **Special Mines**, the court referred to the clean hands doctrine but did not accept that the actions that constituted a breach of contract constituted a lack of clean hands. In **Malik**, the court made no comment on the clean hands doctrine as it found the defendant was not entitled to equitable set-off in any case.

[58] In Kelly R. Palmer, *The Law of Set-Off in Canada* (Aurora, Ontario: Canada Law Book Inc., 1993) at page 66, it states:

> Equitable set-off:
>
> > 1. *Requires clean hands* – in a claim for equitable set-off, the courts will apply the equitable maxim, "He who comes into equity must come with clean hands."
> >
> > …
> >
> > An established equitable principle is that "The plaintiff must not only be prepared now to do what is right and fair, but he must also show that his past record in the transaction is clean; for 'he who has committed inequity…shall not have Equity.'"
> >
> > The application of this maxim in the context of equitable set-off has long been recognized. "Courts of Equity allowed set-off, but the Court of Equity, following the spirit of the statutes, [of set-off] would not allow a man to set off, even at law, where there was an equity to prevent his doing so; that is to say, where the rights, although legally mutual, were not equitably mutual." Canadian courts have adopted this view by stating that: "We are here dealing with equitable principles. Courts of Equity do not permit parties to gain advantages that accrue to them solely through their own default."

[59] Canadian cases where courts have accepted the principle that a party seeking equitable set-off must come to the court with clean hands include: **Advocate General Insurance Co. of Canada (Provisional Liquidator of) v. Peter Rocca Insurance Brokers Inc.**, [1996] O.J. No. 121; **Little Island Fisheries Ltd. v. Royal Harbour Seafoods Inc.**, 2009 NSSC 301, para 76.

[60] If a court determined that the fundamental equitable principle of clean hands should not apply with respect to equitable set-off, it would do so directly and not leave it to inference.

[61] I am satisfied the judge was entitled to and did consider the clean hands doctrine. He specifically refers to Mr. Bardsley's conversion of the drill rig and improper withdrawal of money from High Performance at the time he denied set-off.

[62] The appellants argue the judge applied the clean hands doctrine wrongly on the facts before him. They say it cannot be applied too broadly and that the dirt on the hands must be related to the equity sought, as opposed to simply an allegation of bad character generally or "general depravity".

[63] In addition to the conversion of the drill rig and the improper withdrawal of money from High Performance, the judge made further findings concerning Mr. Bardsley's conduct in his main decision:

Findings Regarding The Masdar Contract

> [167] High Performance's failure can be attributed to its having been deprived of the Snijders report, which High Performance had paid for through Mr. Bardsley's wrongful appropriation of funds. He outrageously demanded that High Performance pay over again when his consent was required. I find that he knew High Performance could not pay.
>
> [168] I am satisfied that withholding the Snijders report contributed to the failure of the MASDAR contract. I find that the withholding, and Mr. Bardsley's behaviour throughout, was motivated by an intent to deprive High Performance of the benefits of the contract and to redirect them to Mr. Bardsley's company.

Findings Regarding Groundless Suits

> [170] *Groundless Suits*. Mr. Bardsley caused numerous peculiar suits to be started.

> [171] Mr. Bardsley authorized counsel to lien The Waterton project for $200,000. I find High Performance was owed nothing on this project. Registering the lien was contrary to the articles of association and the shareholder oppression order. Also, it was unfounded.
>
> …
>
> [173] In addition to the unfounded claim against The Waterton project, between March and July of 2009 Mr. Bardsley caused six suits to be started by High Performance. Most or all of them were unfounded. Each was a violation of the articles of association and the shareholder oppression order.
>
> [174] Between June and September of 2009, Mr. Bardsley caused Palmer Refrigeration to start suits or file liens in relation to High Performance projects. In one case, his wife served him with a Small Claims Court claim against High Performance and he let it go to default. The falsely procured judgment was set aside.

Findings Regarding Breach of Fiduciary Duty

> [206] A director is a *per se* fiduciary of the company. It is submitted for Mr. Bardsley that in "the particular circumstances that exist" he is not a fiduciary to High Performance. I will discuss that submission later. For now, let me say that he owed the company a fiduciary obligation to loyally carry out its instructions and to use its money for its good, not his own.
>
> …
>
> [243] For the respondents, it is argued that by the time Palmer Engineering took over the MASDAR subcontract, High Performance was unable to perform it. That is so, but Mr. Bardsley's breach of fiduciary duty has a much longer history.
>
> [244] The breach began in June, 2009 when Mr. Bardsley took High Performance's money and used much of it to pay for a report High Performance had commissioned. The breach continued when Mr. Bardsley kept the report from High Performance, especially when it was required for a delivery under the contract. And, it culminated after High Performance failed, when Mr. Bardsley's company used the report to complete the project to its profit.

[64] The receiver's October 3, 2014 factum responds to the appellants' arguments that the judge applied the clean hands doctrine too broadly:

> [9] This pattern of conduct was neither abstract nor general. Quite the opposite: it was a series of actions by the Appellants, all intended to either harm of hinder the interests of High Performance Energy Systems.

[65] I am satisfied the judge did not apply the clean hands doctrine too broadly. Mr. Bardsley's actions were directly related to the equitable remedy sought. They were much more than an indication of bad character or "general depravity".

[66] I also disagree that the judge erred in considering whether the requested set-off would amount to an unfair preference. High Performance was being placed in receivership by the judge's order. If set-off were granted, it would defeat the intent of the receivership by giving one creditor preference over other unsecured creditors. If set-off were denied, the appellants would be required to pay their debts to High Performance with little chance of recovery from High Performance of any amount found to be owed to them by High Performance.

[67] Such considerations are not uncommon when equitable set-off is sought in the receivership and bankruptcy context: **EBF Manufacturing Ltd. v. White**, 2010 NSSC 225; **King Insurance Finance (Wines) Inc. v. 1557359 Ontario Inc. (Willowdale Autobody Inc.)**, 2012 ONSC 4263; **Aboussafy v. Abacus Cities Ltd.**, 1981 ABCA 136 (Can LII).

[68] The judge did not err in considering this issue.

[69] The judge made no error on an extractable issue of law or palpable and overriding error in denying equitable set-off to the appellants. I would dismiss this ground of appeal.

Disposition:

[70] I would dismiss the appeal with costs for the individual respondents in the amount of $10,000, and for High Performance in the amount of $15,000, both including disbursements, payable forthwith by the appellants to the respondents.

Hamilton, J.A.

Concurred in:

Fichaud, J.A.

Bryson, J.A.