

Modest punitives, big costs in 'ponzi' scheme

Breach of warranty of authority that company was solvent and existed

BY MICHAEL FITZ-JAMES
For Law Times

The principal of a dissolved and insolvent "investment company" cannot hide behind the corporate veil and is personally liable to a pair of investors he cheated in a fraudulent "ponzi" scheme.

Ontario Superior Court Justice Alexandria Hoy ordered Donald Carmichael, the sole officer of the now-dissolved Kingscroft Investments Ltd., to personally pay investors John Biondich, and his common-law partner Franciska Adamic, a total of more than \$202,000 — a figure which includes \$5,150 in punitive damages for the defendant's fraud.

On top of the award, Hoy ordered Carmichael to pay the plaintiffs \$34,000 in costs on a "substantial indemnity" basis. Carmichael has apparently appealed and the investors' lawyer Gregory M. Sidlofsky, of Toronto's Kramer Henderson, tells *Law Times* he's going to move for security for costs.

"If Carmichael wants to proceed with his appeal, hopefully a

judge will make him pay a lot of money to pursue his remedy," he says.

Sidlofsky says the defendant tried to argue that he was attempting to revive Kingscroft Investments, whose Ontario corporate charter was dissolved because of unpaid taxes.

But Hoy rejected that, and for good reason says Sidlofsky: "If you were allowed to argue that as a defence, then everyone who trades using a dissolved corporation would simply revive the corporation, or claim they were about to.

"It seems that whether or not the corporation's revived, if you contracted with its principal when it was dissolved, then that principal is personally on the hook as the person who warranted it to be existing."

In 1996, Biondich and Adamic responded to a door-to-door flyer distributed by Mike Changoo, who claimed he was a University of Toronto professor offering income tax preparation services.

Changoo learned from their income tax returns that Biondich and Adamic, both



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elderly pensioners, had savings. He introduced them to Carmichael, telling them he could provide a higher-than-average return on their investments. (Changoo collected a seven-per-cent commission on all the business he referred.)

Biondich made a \$10,000 investment in April 1997, and signed a "commitment agreement" promising a 12-per-cent

return on capital. The investment was allegedly in a mortgage on the Bonaventure Court Rental Condominium in Calgary. About a month later, Biondich invested another \$12,000 with Kingscroft.

Carmichael paid Biondich his \$22,000 back with interest in the spring of 1998, and that prompted the investor and his spouse to pour even more money into Kingscroft. Eventually the pair had \$169,400 in investments, which matured in March and April 2001.

In reality, Carmichael had done nothing to perfect the investors' security interest in the Calgary mortgage, plus he ignored all the Ontario Securities Act requirements for these alleged trades in securities.

The investors became concerned they weren't getting T5 slips for their returns, and they discussed with Changoo the possibility of getting out of Kingscroft. Changoo, who seems to have acted as a go-between for Carmichael, told them not to worry.

In April 2000, Changoo died, prompting what Carmichael later called "a run on the bank" from investors he'd introduced to Kingscroft.

In April 2001, Biondich and Adamic demanded some their maturing investments back (others they renewed), but they never

dissolved by Ontario's Ministry of Finance in October 1995.

Carmichael attempted to hide behind his dead company. He argued that he wasn't personally liable to the investors, even though he was trading after the corporation had been dissolved.

He pointed to a 1985 Ontario District Court case, *Royal Bank of Canada v. Starr (c.o.b. Etmor Ltd.)*, and argued that he should be found personally liable only if he was negligent, exercised wilful blindness about the dissolution, or had constructive or actual knowledge of the Kingscroft Investments dissolution.

Hoy wasn't impressed. The case, she says, stood for the proposition that defendants who trade using a dissolved corporation personally warrants that the corporation has authority to conduct business.

The defendant trading using the name of a dissolved corporation is deemed, by the Ontario Business Corporations Act, to have knowledge of its dissolution.

In any event, Carmichael knew of the dissolution of Kingscroft Investments. Although the Ministry of Finance stopped "chasing him" before 1997, he knew if he didn't pay his taxes, his company would be dissolved. If he didn't know that, he should have known, says the judge.

Canadian Business

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to any lawyer, but they never got their money. Starting in June 2001, Carmichael wrote the pair a series of increasingly "inventive" letters detailing repossession of condominium units, gold bullion deals, and U.S. immigrant investors with millions to invest.

When they finally sued, the true facts about Kingscroft came out: It was insolvent and had no employees or office space — Kingscroft's premises, according to Carmichael, were "wherever he was."

Its only assets were receivable promissory notes from purchasers of units in the Calgary property, and a second mortgage on that property.

Carmichael and Kingscroft had also been convicted for carrying on business as a mortgage broker without a licence as a result of trying to sell off part of the second mortgage in an attempt to get cash.

Kingscroft owed tax arrears to the Canada Custom and Revenue Agency and Ontario's Ministry of Finance. Kingscroft, Hoy found, "survived by borrowing money, which it appeared to have no reasonable prospect of repaying from individuals such as the plaintiffs."

Any money paid to Kingscroft Investments was transferred to Kingscroft Capital Corporation, a corporation owned by Carmichael. Kingscroft Capital supposedly paid Carmichael a "salary" of \$80,000 a year — although he couldn't produce evidence to show this.

It also turned out Kingscroft Investments hadn't paid its taxes since 1991, and had been

known, says the judge.

Carmichael was not only liable for breach of warranty of authority, but also for civil fraud. He argued the investors knew their investments were high risk and high reward and just because Kingscroft Investments ran out of money was no reason to find fraud.

But Hoy pointed out the essence of civil fraud is "dishonest dealing."

Carmichael took investors' money when he knew his company was insolvent, and basically used the funds for personal draws or to pay off other investors — he was basically running a "ponzi" scheme, she says.

There were huge misrepresentations and outright fictions in the letters he'd written to investors in 2001. It was clear he was engaged in fraudulent conduct.

Hoy says punitive damages had to be determined by the Supreme Court criteria in *Whiten v. Pilot Insurance Co.*, and since Carmichael engaged in deliberate misconduct resulting in unsophisticated investors losing their savings that departed to a marked degree from ordinary standards of decent behaviour."

Plus Carmichael's fraud was "within the definition of criminal fraud," but there was no evidence he'd ever been charged. But he wasn't malicious or vindictive, so Biondich was awarded a fairly modest \$4,750 in punitive damages and Adamic \$400.

Carmichael was represented by Toronto lawyer Charles G. Ashton, who would not comment on the case.