$200,000 damages awarded victims of investment fraud

By John Jaffey
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For masterminding a Ponzi scheme, the principal of a dissolved corporation has been found liable to repay two unsophisticated investors more than $200,000 including $5,150 in punitive damages.

In making the award, an Ontario Superior Court judge found that Donald Carmichael's conduct constituted both fraud and breach of warranty of authority.

In April 1997, John Biondich, a retired roofer, and Franciska Adamic, a salad bar clerk, began lending money to Kingscroft Investments Limited, an Ontario corporation that had been dissolved in 1995 for failure to pay capital taxes.

Justice Alexandra Hoy said they were talked into the loans by an unscrupulous "financial planner," who held himself out to be a partner in Kingscroft. In fact, he was an independent loan broker who received a 7 per cent commission on the funds he arranged. He assured them that their investments were secured by a security agreement and a "pool of promissory notes" on a Calgary condominium building; they were "as safe as money in the bank."

In fact, Kingscroft and Carmichael, its sole director, officer and shareholder, were surviving on borrowed money with no reasonable prospect of repayment. Both had previously been convicted of carrying on business as a mortgage broker without a licence.

In April 1998, Kingscroft repaid Biondich's existing $22,000 loan with interest. As a result, he and his wife Adamic gained confidence in the financial planner and in Kingscroft, and lent Kingscroft about $170,000 over the next two years.

Then the financial planner died, and Biondich wrote Kingscroft to advise that he and his wife wanted to cash out their investments. Though Kingscroft was not in a position to repay these and other loans, Carmichael replied that the company was increasing in value and acquiring new properties. Instead of sending cheques, he sent renewal agreements, which Biondich and Adamic signed.

In October, 2001, Carmichael wrote "the most inventive of his letters" with updates on Kingscroft's fictitious transactions including a gold bullion deal. He stated: "We are still maintaining our yields in the position trade; however, we have yet to add any further capital to the fund in order to generate a discretionary surplus."

Finally, Biondich and Adamic sued Kingscroft and Carmichael for the return of their investment and for punitive damages. Kingscroft admitted liability.

At the opening of the trial on November 18, the amounts were not in dispute: $182,500 was owing to Biondich and $14,200 to Adamic.

Justice Hoy held that Carmichael was liable to the plaintiffs for breach of warranty of authority for signing loan documents on behalf of Kingscroft after it was dissolved. She based her decision on *Royal Bank of Canada v. Starr (c.o.b. Ettmor Ltd.)*, [1985] O.J. No. 1763, which held that the defendant in that case warranted both his signing authority and the existence of the dissolved corporation by his signing of a promissory note on behalf of the dissolved corporation and by his representations in the period preceding the execution of the note.

In finding Carmichael also liable for fraud, Justice Hoy rejected arguments that the commitment agreements did not restrict what Kingscroft could do with the borrowed money and that the plaintiffs freely made a high-risk, high-reward investment, which Kingscroft simply was unable to repay.

She found that Carmichael's conduct went beyond taking advantage of a business opportunity to the detriment of the investors.

"His conduct went beyond sharp practice," she wrote. "He took the plaintiffs' money at a time when Kingscroft appears to have been insolvent and when ... he knew that Kingscroft had been dissolved." In addition, Carmichael had intentionally misrepresented Kingscroft's financial position in an attempt to convince the plaintiffs to renew their loans.

Thirdly, the judge determined that the claim for punitive damages met the requirements of *Whiten v. Pilot Insurance Co.*, [2002] S.C.J. No. 19: "Punitive damages should be assessed in an amount reasonably proportionate to the objectives for which the punitive damages are awarded, namely punishment, deterrence and denunciation. Such factors as the harm caused, the degree of misconduct, the vulnerability of the plaintiffs, the profit gained by the defendant and other penalties suffered by the defendant for the misconduct in question should be considered."

Noting that Carmichael used the plaintiffs' money for his own benefit over a period of about four years and that the plaintiffs were vulnerable, unsophisticated investors, Justice Hoy awarded $4,750 to Biondich and $400 to Adamic.

Gregory Sidlofsky of Kramer & Henderson acted for Biondich and Adamic. Charles Ashton represented the defendants.

Reasons in *Biondich v. Kingscroft Investments Ltd.*, [2002] O.J. No. 4742, are available from FULL TEXT: **2236-027**, 14 pp.

Defamation suit by B.C. doctor