IN THE SUPREME COURT OF NOVA SCOTIA
Citation: White v. E.B.F. Manufacturing Ltd., 2004 NSSC 152

Date: 20040910
Docket: SH 163572
Registry: Halifax

Between:

Eric White

Plaintiff/Defendant
by Counterclaim

v.

E.B.F. Manufacturing Limited

Defendant/Plaintiff
by Counterclaim

Judge:	The Honourable Justice Glen G. McDougall
Heard:	October 6, 7, 14, 15, 16, 17, 20 and 21, 2003 in Halifax, Nova Scotia
Counsel:	David Farrar and Colin D. Piercey for the Plaintiff/Defendant by Counterclaim Michael J. Wood, Q.C. and David Hutt, for the Defendant/Plaintiff by Counterlaim

McDougall, J.:

[1] The horse many have left the barn but has it also managed to escape the paddock? The plaintiff, Mr. Eric White ("White") would suggest that it has but Mr. David Bryson ("Bryson"), the president and now sole owner of all issued shares of E.B.F. Manufacturing Limited ("EBFML") and ElectroBraid Fence Limited

("ElectroBraid Fence") would argue otherwise. It is then left to the court to determine on which side of the fence the horse might be.

BACKGROUND

[2] White grew up on the northeast coast of Newfoundland. He left school after Grade IX but later obtained a General Educational Development Grade XII equivalency. He went on to study fine arts and photography and, although he worked for a time in photography, his main work experience has been in the field of aquaculture. In the past he has been involved in a couple of different business ventures related to aquaculture and seafood.

[3] White and Ms. Jennifer Fried ("Fried"), his life and business partner, for a time operated a seafood company known as Genera Seafoods. Fried also owned and operated her own business named Clearwater Well-Drilling Limited ("Clearwater").

[4] Fried, as well, owned and operated a horse farm. When White went to live with Fried on her farm he helped out by repairing and maintaining the fences. As one

would expect this consumed a great deal of time and effort - a sort of necessary evil for anyone owning horses.

[5] Sometime in 1994, White turned his mind to designing a new system of fencing that would require less time to install and maintain. It would, as a result, be less expensive than the traditional wooden fence but without sacrificing reliability or animal safety. His ingenuity and resourcefulness resulted in the creation of a braided rope product containing a copper wire through which low voltage electricity could be conducted. Development of the new product occurred over an approximately two year period. Finally, in 1996, White decided to apply for a patent for his invention which he called "ElectroBraid fence". He had never before applied for a patent.

[6] With his new product and Fried's knowledge of the horse business, White and Fried decided to form a company to market the product.

[7] The original EBFML business plan called for White to own 51% of the shares, Fried 20% and two other prospective shareholders would own 20% and 9% respectively. White was also to be paid a salary of $50,000.00 per annum and Fried $20,000.00. One other shareholder would have received $50,000.00 per annum and

the fourth paid on a fee-for-service basis. At least initially, in order to get the business started, White would not be paid royalties but because he had no other sources of income he needed to be paid a salary.

[8] White and Fried had successfully arranged some of the required financing for their new venture. In order to obtain additional funding and in an effort to devote more attention to the new venture, Fried decided to sell Clearwater. Through her accountant she was introduced to Bryson who was looking to acquire a small business. During the course of their initial meeting to discuss the purchase of Clearwater, Bryson became aware of EBFML and immediately expressed an interest in learning more about it.

[9] Bryson was provided with a copy of the business plan. After reviewing it his interest in purchasing Clearwater faded - he was now focussed on the potential of EBFML. A series of meetings took place during which Bryson convinced White and Fried that he had sufficient capital and the business acumen needed to help them successfully launch the new business venture. He was prepared to invest, by way of a shareholder's loan, some of the money needed to get the business up and running. After a number of discussions and written proposals, that more or less served as

discussion pieces, Bryson persuaded White and Fried to drop the other two prospective shareholders and to restructure EBFML so that ultimately he would become owner of 50% of the issued share capital and White and Fried would each own 25%. Bryson would then become president of the new company, Fried the secretary/treasurer and White chair of the board of directors. These discussions, which ultimately culminated in the formation of EBFML and the creation of a shareholders' agreement which was signed on September 4, 1997, took place over several months beginning in the Spring of 1997. In all of these discussions all three individuals actively participated but it was Bryson who took the lead in generating written letters and documents or notes of meetings that in turn were used to generate further discussion at subsequent meetings. Bryson drew upon his extensive knowledge gained from years of experience in business to take the lead role in these discussions. White and Fried, although not nearly as experienced in matters of business as Bryson, were by no means devoid of business knowledge. Having said that, there can be no doubt of the lead role taken by Bryson in the discussions and negotiations that led up to the ultimate creation of EBFML and subsequently ElectroBraid Fence as well as the shareholders' agreement and a license agreement signed on the 29th day of January, 1998.

[10] The idea to incorporate ElectroBraid Fence was Bryson's. Although it never became party to the shareholders' agreement, nor was a separate shareholders' agreement even created for it, its share structure mirrored that of EBFML. It was decided that EBFML would own all the business assets and ElectroBraid Fence would be used to sell the product and act as a buffer between EBFML and its customers. This would be particularly important when the company began marketing its products in the United States of America ("USA") as a shield against any law suits that might arise in what the shareholders perceived to be a more litigious market. Although sales of EBFML products were made by both companies most of the sales to end-users were eventually funnelled through ElectroBraid Fence.

[11] The Fall of 1997 was spent attending equine events at Spruce Meadows in Alberta and the Royal Winter Fair in Toronto. The trio of business owners sought to introduce the new product which was still in a patent pending status. Initial reaction was, as the three owners anticipated, very positive. Based on this they proceeded with preparations to bring the product to market.

[12] Fried, thanks to her many contacts in the horse business, and White, because of his intimate knowledge and understanding of the product, both contributed to the marketing and sales of the company's products.

[13] Bryson, with his relatively vast experience in business, took charge of the set-up and administration of the new company. He assumed responsibility for the accounting function utilizing the services of individuals who had or were still working for some of his other business ventures. He also took responsibility for hiring employees from time to time as needed.

[14] It was Bryson's idea to contract out the manufacture of the electrobraid fence to a company called Novatec Braids Limited ("Novatec") which was located in Yarmouth, Nova Scotia. Novatec and its officers were required to sign a confidentiality and non-competition agreement with EBFML and its principals to protect EBFML's interest in the product invented by White. While this was taking place EBFML was pursuing additional financing. Prior to accessing additional funding from Nova Scotia Business Development Corporation ("NSBDC"), White entered into an exclusive license agreement with EBFML as called for in clause 4.02 of the shareholders' agreement referred to earlier. Clause 4.02 states:

> White shall acquire and retain ownership of any patent or patents that are to be used by the Company in connection with its business. By agreement to be approved by the directors of the Company, White shall grant to the Company an exclusive license, for one day less than the legal lifetime of the patent or until the Company sooner becomes insolvent, of any such patent as acquired by him in exchange for a royalty payment, in respect of all such patents, equal to Two Per Cent (2%) of the Company's gross revenues which shall continue in the event of White's insolvency.

[15] This license agreement dated the 29th day of January, 1998 was signed by White, Fried and Bryson both in their personal capacity and on behalf of EBFML It is interesting to note that the exclusive license was granted only to EBFML. However, on the same day the shareholders' agreement was signed — September 4, 1997 — White, Fried and Bryson had also signed another one-page agreement that made reference to clause 4.02 of the shareholders' agreement. In the second paragraph of this one-page agreement it was stated:

> In that event we agree promptly to form another company, with identical voting common shares as EBF Manufacturing Limited, to which Eric White will grant a similar exclusive license.

The event referred to was the insolvency of EBFML or any other company that might possibly be granted such an exclusive license in the event EBFML actually did become insolvent.

[16] The license agreement was drafted by a lawyer retained by EBFML. In the cover letter sent to the three principals of EBFML enclosing a draft of the license agreement counsel wisely suggested two things:

> ... As discussed with you, I do not have experience with patents and it would be prudent to have the document reviewed by your patent lawyer. Also, you may want to add further details - for example, paragraph 4 does not specify when royalty payments are to be made, including the commencement date for such payments.

One other interesting comment in this letter (which was tendered as an exhibit without calling the author) is:

> My understanding is that all of the equipment is to be owned by E.B.F. (by E.B.F. she meant E.B.F. Manufacturing Limited - my comment) and that Electrobraid (by Electrobraid she meant ElectroBraid Fence Limited - my comment) simply acts as an agent on behalf of E.B.F. I have prepared the document on this basis.

[17] The manner in which royalty payments were to be calculated and the timing of those payments, formed the basis of this law suit. Indeed White contends that the refusal of EBFML to pay royalties has resulted in a repudiation of the license agreement. He seeks an order to this effect as well as an accounting of all royalties owed to him since the company's formation including all sales made through ElectroBraid Fence.

[18] Bryson, who now owns all the shares in both companies, argues that there has been no repudiation of the license agreement by EBFML and is prepared to pay any monies owed to White should the court decide that royalties have not been properly calculated.

[19] If the court was to accept White's position then Bryson would be the sole owner of two companies that own a considerable amount of production equipment but with little or nothing to produce. Furthermore, the companies would be liable to White for damages and/or an accounting of profits for the unauthorized use of his intellectual property and for patent infringement.

[20] It should be noted that White did not seek a declaration that the license agreement had been repudiated nor damages and/or an accounting of profits in his original action filed on May 17, 2000. This was done later by way of amendment filed on March 28, 2001 and by further amendment on June 6, 2002.

[21] In addition to this action, the parties have commenced other court proceedings both in this court and in the Federal Court of Canada. At one point a court monitor had to be appointed to oversee the operations of the companies. Certainly what had begun as a mutually beneficial business arrangement based on trust and good faith has deteriorated to the point where no one is now talking. The on-going business relationship, if any, will be decided by this court.

ISSUES TO BE DECIDED

(1) Has there been a repudiation of the license agreement by EBFML and, if so, has White, by his actions, accepted the repudiation?

(2) Based on the agreements between the parties (both the shareholders' agreement and the license agreement) when and how should royalties be calculated?

DISCUSSION and DECISION

[22] Both clause 4.02 of the shareholders' agreement and clauses 1 and 4 of the license agreement, signed on September 4, 1997 and January 29, 1998 respectively, clearly stipulate that White was to receive 2% of the company's gross revenues as a royalty payment in return for an exclusive license to use all patents and patents pending.

[23] Although the term "gross revenues" was not defined, there is nothing to suggest that it should not be given its ordinary accounting definition. This was even suggested to Mr. E.C. Harris, Q.C. in correspondence sent to him by Mr. Douglas Reid, C.A. on the 12th day of November 1999. That definition states:

> ‘Gross revenues’ represents the total sales, net of sales discounts, of the Company. They will be reported on the financial statements of the Company as ‘sales’, or ‘revenue’.
>
> The corporate structure that the Company currently operates within raises an issue. In our view it is reasonable that the agreements contemplated ‘gross revenues’ to be sales to the consumer, or third party sales. The current management structure sees the Company selling the product to Electrobraid Fence Limited, a company with identical ownership to the Company, at a price that may not be representative of the sales made to the third party purchaser.
>
> Therefore, we believe the parties to the agreement should clarify that ‘gross revenues’ be the gross sales, net of sales discounts, as reported by Electrobraid Fence Limited, using generally accepted accounting principles.

[24] Both Messrs. Harris and Reid had been called upon at one time or another to provide professional legal and/or accounting advice to the companies and its shareholders.

[25] It is interesting to note that the lawyer who had previously drafted the license agreement identified some shortcomings in the agreement related to the timing of royalty payments but she did not express any concerns about the method of calculation. It is 2% of gross revenues defined as the total sales or revenue to third party buyers. If the sale was made either by EBFML or ElectroBraid Fence directly to the end user or discounted to an agent of the companies then that is the amount that should be used in calculating gross revenues. It should not be some potentially arbitrary transfer price from EBFML to ElectroBraid Fence. Sales to end-users or the discounted price offered to company agents, as long as it reflects fair market value, should not be open to manipulation that could potentially harm the patent(s) owner.

[26] The negotiations that led to the royalty amount of 2% involved all three original shareholders. White initially was to be paid a salary before Bryson became involved. He was persuaded to accept the 2% royalty figure because it would prove more beneficial to him in the long run. It would also act as an incentive to White to continue to improve and modify his invention and to work on the creation of new ideas that could potentially generate more revenue for the company(ies). In order to determine the gross revenues of the companies for purposes of calculating the total amount of royalties owing to Mr. White, EBFML and ElectroBraid Fence will be

required to hire a qualified accounting professional to review the financial records of the companies since they began operations in or about September of 1997. All sales of the companies products to end users or the discounted prices given to agents of the companies, for both patented and patent pending products, should be included in the calculation of this amount.

[27] Bryson took the position that royalty payments were not intended to be made on patent pending items. Instead he suggested royalties were to be paid only when the patent was granted and then based on total sales retroactive to the time when the sale occurred. White disagreed with this position. He maintained that he would not have agreed to this arrangement. He needed money to live. If Bryson's interpretation of the agreement was accepted there would exist the possibility that White would not receive anything should his patent application be rejected. Although the timing, including the commencement of royalty payments, was pointed out to the parties by the lawyer who drafted the license agreement, they did nothing to address this concern. Initially this was not a problem. White did not seek royalty payments until sometime in December of 1998, just prior to Christmas. Although he was working full-time and travelling extensively to sell what was still only a patent pending creation, he did not request an advance on his royalties until almost 16 months after

the business started. The company was just getting established and cash-flow was needed to cover other start-up costs. Neither Bryson nor Fried received payments from the company initially although management fees were being booked. They were fortunate enough to have other sources of income from which to draw — White was not.

[28] For whatever reason White did not press the issue, at least not initially. There were other problems associated with internal accounting that contributed to problems in determining the amount of royalty payments accruing to White. The accounting function, as with other administrative functions, was primarily the responsibility of Bryson but Fried also helped run the office. These problems persisted for almost two years from the time the business started. It was sometime in the Fall of 1999 before reliable financial statements could be produced for the years ending September 30, 1998 and 1999.

[29] White knew of these problems and perhaps for this reason and for the other reasons previously stated he did not, at least initially, press for payment of royalties.

[30] When White first requested a payment of royalties in December of 1998 he requested $3,000.00. Instead of refusing to make a payment Bryson instead suggested a higher amount of $5,000.00 as an advance against future royalty payments. There was never a refusal to pay although Bryson up to this point in time had never articulated his position that royalties would only be payable once the patent(s) had been granted. This was not suggested until February 7, 2000 in a letter from Bryson's counsel to White's counsel. If this was truly Bryson's position I find it curious that he did not make this clear before then. No doubt White's own approach to payment might have influenced this.

[31] I find that White had ample opportunity to demand payment of royalties he felt he was owed but chose not to. When he did ask for advances he received payment although Bryson refused to sign two cheques originally cut for him in the Spring of 1999. His stated reasons for refusing to sign were the problem with the reliability of the accounting information, the manner in which the company accountant made the calculations and the financial position of the company at the time. After additional financing was arranged and based on favourable reports about the status of the patent application, an additional $20,000.00 was advanced to White just a few months later.

[32] Unfortunately the business relationship between the three shareholders continued to deteriorate. In one camp was White and Fried and in the other, Bryson. In particular, the working relationship between Bryson and Fried was becoming more and more untenable. Bryson would have been happy to continue in business with White without Fried. The feeling was mutual. Despite this the three shareholders continued operations.

[33] Discussions continued in an effort to resolve the differences in opinion that prevailed. Both Bryson and White sought professional advice to clarify the meaning of the existing agreements. Ultimately it led to a complete breakdown of the business relationship. White brought action against EBFML for payment of the royalties that he felt was owed to him. The company defended the action and initially counter-claimed for the costs and expenses for filing and pursuing patent applications. The counterclaim was later amended to instead seek damages for losses allegedly suffered by the company as a result of White's unlawful interference with its business relationship with its customers and suppliers. This was as a result of letters sent by White's counsel to customers of EBFML and to the manufacturer of ElectroBraid fencing threatening legal action for EBFML's alleged unlawful use of White's intellectual property. The counterclaim was eventually dropped.

[34] After the original patent for ElectroBraid fence was granted on March 27, 2004, EBFML tendered payment of the royalties demanded by White. Initially White, on the advice of counsel, refused to accept the payment based on the conditions under which it was being offered. Eventually the parties agreed that all conditions would be dropped and acceptance of payment by White would not prejudice his lawsuit against EBFML.

[35] Based on the evidence presented before me I do not find that there has been a repudiation of the agreement. The parties might not have agreed on exactly when royalty payments should have begun but clearly there has never been a denial of White's entitlement to receipt of eventual payment.

[36] The proper method of calculating the amount of royalties owed to White is also a matter of contention. The proper approach is to interpret the relevant portions of the shareholders' agreement and the license agreement by giving them their ordinary meaning. This is what was suggested by Mr. Douglas Reid, C.A., in his letter to Mr. E.C. Harris, Q.C. and, as I indicated earlier, I accept the meaning he provided for 'gross revenues'.

[37] With regard to the timing of royalty payments, I do not accept Bryson's position. Although it is open to this interpretation, I find it strange that he did not express this opinion until well after the company(ies) began operating. White on the other hand did very little to demand payment of what he claims was being withheld from him. His conduct in allowing this to continue was tacit acceptance of the timing of payments although perhaps not the method of calculation.

[38] For a comprehensive review of the law of fundamental breach resulting in a repudiation of a contract one only has to look to the Nova Scotia case of **Central Automatic Sprinkler Ltd.** v. **Trident Construction Co.**, 2000 Carswell 119 (S.C.) which is a decision of the Honourable Justice Suzanne M. Hood. At paragraphs 186 to 190, Justice Hood wrote:

> 186 The leading case in Nova Scotia on fundamental breach of contract is *Canso Chemicals Ltd. v. Canadian Westinghouse Co.* (No. 2) (1974), 54 D.L.R. (3d) 517 (C.A.). In that case, in his dissenting opinion, MacKeigan, C.J.N.S. referred to nine ways in which fundamental breach has been described in various cases. He cites these as follows at pp. 524-25:

• whether in consequence of it [the breach] the performance of the contract becomes something totally different from that which the contract contemplates - Viscount *Dilhorne in Suisse Atlantique, supra*, at p. 393.

• a situation fundamentally different from anything which the parties could as reasonable men have contemplated ... - Lord Reid in *Suisse Atlantique*, at p. 397.

• a breach which goes to the root of the contract - *idem*, p. 399.

• when there is such a congeries of defects as to destroy the workable character of the machine - *Pollock & Co. v. Macrae*, [1922] S.C. (H.L.) 192 at p. 200 (quoted by Lord Hodson in *Suisse Atlantique* at p. 413[)].

• destroying the whole contractual substratum - Lord Wilberforce in *Suisse Atlantique* at p. 433.

• totally different performance of the contract from that intended by the parties and which will 'undermine the whole contract' - Sellers, L.J. in *Hong Kong Fir Shipping*

Co., Ltd. v. Kawasaki Kisen Kaisha, Ltd., [1962] 1 All E.R. 474 (C.A.) at p. 479.

• an 'event'... which has deprived the plaintiffs of substantially the whole benefit which they were to obtain under the contract - Widgery, L.J., in *Harbutt's Plasticine Ltd. v. Wayne Tank & Pump Co. Ltd.*, [1970] 1 All E.R. 225 at p. 239.

• so defective as to be quite incapable of performing the function which both parties contemplated it should perform ... resulting in performance totally different from what the parties had in contemplation - Arnup, J.A., in *McLean, supra*, in 15 D.L.R. (3d) 15 at p. 20, [1971] 1 O.R. at p. 212.

• an accumulation of defects which, taken en masse, constitute such a ... breach going to the root of the contract, as disentitles a party to take refuge behind an exception clause intended to give protection only in regard to those breaches which are not inconsistent with and not destructive of the whole essence of the contract - Pearce,

> L.J., in *Yeoman Credit, Ltd. v. Apps*, [1961] 2 All E.R. 281 at p. 289.

187 He then refers at pp. 525-26 to the test set out in *Suisse Atlantique* by Lord Wilberforce:

> ... it leaves to be decided what is meant by a 'total' breach for this purpose - a departure from the contract? but how great a departure?; a delivery of something or a performance different from that promised? But how different? No formula will solve this type of question and one must look individually at the nature of the contract, the character of the breach and its effect upon future performance and expectation and make a judicial estimation of the final result.

188 Coffin, J.A., for the majority, at p. 530 also refers to the decision in *Suisse Atlantique*, but quotes from Lord Reid:

> One way of looking at the matter would be to ask whether the party in breach has by his breach produced a situation fundamentally different from anything which the parties could as reasonable men have contemplated when the

> contract was made. Then one would have to ask not only what had already happened but what was likely to happen in future.

189 He also refers at p. 531 to Lord Justice Widgery in *Harbutt's Plasticine Ltd. v. Wayne tank & Pump Co. Ltd.*, [1970] 1 All E.R. 225:

> ... the first step is to see whether an 'event' has occurred which has deprived the plaintiffs of substantially the whole benefit which they were to obtain under the contract ... if the event which occurs as a result of the defendants' breach is an event which would have frustrated the contract had it occurred without the fault of either party, then the breach is a fundamental breach for present purposes.

190 He then concludes at p. 531:

> Whether a breach is fundamental or not must, in the last analysis, be decided by reference to the contract and the circumstances in each particular case.

[39] Although I do not accept Bryson's interpretation of the license agreement as it relates to the timing of payments, he never denied that royalties would eventually

be paid. And, as stated earlier, I find that White's own conduct contributed to the misunderstanding that developed.

[40] To order the declarative relief now being sought by White would, in effect, put EBFML and ElectroBraid Fence out of business. This would strip Bryson of any benefit he should have received under the shot-gun provisions of the shareholders' agreement which was used to buy out White and Fried's shares in the companies. This transaction took place on September 29, 2000. It was after this that White's statement of claim was amended to seek a declaration that the license agreement had been repudiated. If EBFML could not rely on the exclusive license it held over White's patent(s), what would it manufacture and sell? For the reasons previously stated I do not think the actions of Bryson as president of EBFML amounted to a repudiation of the license agreement. It is therefore still valid and enforceable.

[41] I also earlier indicated that a proper review of the companies' financial records should be conducted in order to calculate total gross revenues from the time the companies first began operations. If the parties cannot agree on who to appoint for this purpose, the court will select a qualified individual or firm after hearing further submissions from counsel. The process of selecting the appropriate individual or firm

should be completed within 60 days of the date of this decision. White is also entitled to interest on all unpaid royalties at a rate equal to the average interest that EBFML would have had to pay on any monies borrowed from its bank during the period from its inception in September, 1997 up to the present day. Interest is not to be compounded.

[42] All other relief requested by White in his "amended amended statement of claim" filed on June 6, 2002 is denied.

[43] All future royalty payments should be paid by EBFML/ElectroBraid Fence to White on a monthly basis in the manner described herein unless the parties mutually agree to some other arrangement.

[44] If the parties cannot agree on costs, I will expect to hear from them by way of further written submissions.

J.