CITATION: SureFire v. Berkshire Hathaway, 2023 ONSC 4535
COURT FILE NO.: CV-20-00634017-0000
DATE: 2023-08-04

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:	
SUREFIRE DIVIDEND CAPTURE, LP Plaintiff	*Raj K. Datt and Marie-Pier Nadeau*, for the Plaintiff
– and –	
NATIONAL LIABILITY & FIRE INSURANCE COMPANY c.o.b. as BERKSHIRE HATHAWAY SPECIALTY INSURANCE and ARTHUR J. GALLAGHER CANADA LIMITED Defendants	*Reid Lester and Pavle Masic*, for the Defendant National Liability & Fire Insurance Company c.o.b. Berkshire Hathaway Specialty Insurance
	HEARD: January 16, 17, 18, 19, 20, 23, 24, 25, 26, 30, 31 and February 3, 2023

CAVANAGH J.

INTRODUCTION

[1] The Plaintiff, SureFire Dividend Capture LP ("SDC"), is a limited partnership formed as a special purpose vehicle to hold investments for its investors using an external investment advisor which employed several different trading strategies. The principal of SDC's general partner is Ariel Shlien. Mr. Shlien had also formed other SureFire limited partnerships as investment vehicles.

[2] Mr. Shlien heard about a hedge fund in the United States managed by Brenda Smith called Broad Reach Capital, LP ("BRC") that employed several investment strategies including one called "dividend capture". Mr. Shlien investigated BRC and spoke with Ms. Smith. He decided to cause SDC to invest in BRC to take advantage of its trading strategies. In several instalments, SDC paid a total of $4,510,000 USD to BRC and, in exchange, received a limited partnership interest in BRC.

[3] At the time that Mr. Shlien was investigating BRC, he was also looking to obtain insurance coverage for theft and fraud by SureFire's underlying fund managers, including BRC. Mr.

Shlien used an insurance broker, Arthur J. Gallagher Canada Limited ("Gallagher"), to assist him to look for this insurance coverage.

[4] Gallagher, through Mark Morency, a Senior Vice-President, contacted Berkshire Hathaway Specialty Insurance ("Berkshire") about obtaining insurance coverage for the SureFire entities. Berkshire offered an insurance product that provided fidelity insurance for loss resulting from dishonest and fraudulent acts by employees of the insured, as well as other coverage. Over a number of months from September 2018 to February 21, 2019, Mr. Morency of Gallagher and Andrew Knight of Berkshire exchanged emails and had conversations about coverage, including coverage for SureFire for theft and fraud by sub-advisors, including BRC, that Mr. Shlien had told Mr. Morency he was seeking.

[5] Berkshire issued a Financial Institution Bond for Asset Managers and Broker/Dealers in favour of certain SureFire entities that was effective from January 1, 2019 to January 1, 2020 (the "Bond"). SDC became a named "Insured" under the Bond by a rider that became effective on February 26, 2019. Under a separate rider to the Bond, BRC was included within the meaning of "Subsidiary" in the Bond, but only with respect to its operations or activities on behalf of the SureFire funds.

[6] In the course of his investigations of BRC, Mr. Shlien was introduced to Brian Shevland who was the principal of an asset management firm called Bluestone Capital Management. Through Bluestone, Mr. Shevland operated three investment funds (the "A Funds") which had placed $26,730,000 USD with BRC to be invested using BRC's investment strategies, including dividend capture. The A Funds held limited partnership interests in BRC.

[7] On February 27, 2019, the full balance of the interests of the A Funds in BRC was transferred to SDC by way of an "in-kind" transfer (without the need to liquidate any securities), with the approval of Brenda Smith representing BRC.

[8] Following the in-kind transfer, Ms. Smith began behaving erratically and was not responsive to requests for information from Mr. Shlien and Mr. Shevland. In March 2019, Mr. Shlien received a letter from Ms. Smith's lawyers alleging that he had acted improperly by soliciting her investor. Mr. Shlien decided to redeem out of BRC. BRC promised to process SDC's redemption request but failed to return the balance of SDC's capital account. SDC commenced an arbitration and, through the arbitration process, Mr. Shlien and Mr. Shevland suspected that Ms. Smith had engaged in a fraud.

[9] Regulatory and criminal proceedings were soon commenced against Ms. Smith and others in the United States. On September 9, 2021, Ms. Smith pleaded guilty to one count of securities fraud. Through the admission of allegations in the Indictment in the criminal proceedings, it was established that Ms. Smith had perpetrated a fraudulent Ponzi scheme using BRC.

[10] In its statement of claim, SDC claims (a) a declaration that Berkshire has a duty to indemnify SDC under the Bond for losses resulting from the fraudulent scheme orchestrated and perpetrated by Brenda Smith, among others, through BRC; and (b) damages in the amount of $46,598,676.84 USD resulting from Berkshire's breach of

contract and failure to provide coverage to SDC under the Bond with respect to losses incurred in connection with the fraudulent scheme. SDC also claims punitive damages.

[11] In its statement of claim, SDC claimed damages from Gallagher. SDC's claim against Gallagher was settled during the trial.

BACKGROUND

[12] I am satisfied that the following background facts are established by the evidence.

Parties

[13] SDC is a limited partnership formed pursuant to the laws of the State of Delaware. SDC was formed as a special purpose vehicle specifically to hold investments made using several different trading strategies. SDC was created specifically for the purpose of investing into BRC. SDC did not invest in any other underlying fund managers.

[14] The general partner of SDC is 8569606 Canada Inc. ("8569606"). Ariel Shlien is, through a personal holding company, the sole shareholder of 8569606 and its Chief Executive Officer. In addition to SDC, Mr. Shlien formed other limited partnerships to hold investments using different trading strategies. I refer to these limited partnerships and 8569696, together, as the SureFire entities.

[15] Gallagher carries on business as an insurance, risk management and benefits consulting firm. Gallagher, as an insurance broker, provided consulting and advisory services with respect to insurance to Mr. Shlien.

[16] Berkshire is an insurer and issued the Bond. SDC became a named "Insured" under the Bond by a rider that became effective on February 26, 2019.

SDC's investment in BRC

[17] Broad Reach Capital LP ("BRC") was a limited partnership created pursuant to the laws of Delaware. It was a hedge fund managed by Brenda Smith. The general partner of BRC, Bristol Advisors LLP, was controlled by Brenda Smith.

[18] Mr. Shlien heard about BRC from one of the investors in his investment club. One of the investment strategies that BRC said it employed was "dividend capture". Mr. Shlien found BRC's dividend capture strategy to be a low risk and very interesting trade, and he decided to investigate it.

[19] Mr. Shlien conducted due diligence prior to investing in BRC.

[20] Mr. Shlien negotiated BRC's fees from 50% down to 35%, and once SDC's capital invested in BRC would reach $50 million, the fees would be reduced further to 25%. Ms. Smith agreed to pay the premiums for fidelity bond insurance coverage. These agreements were made pursuant to a side letter agreement dated November 14, 2018.

[21] SDC transferred the following amounts in BRC: $2,049,000 USD on December 26, 2018, $236,000 USD on December 27, 2018, $2,000,000 USD on January 29, 2019 and $225,000 USD on January 31, 2019, for a total of $4,510,000 USD.

[22] Mr. Shlien, on behalf of SDC, executed a Subscription Agreement with BRC on December 19, 2018. The Subscription Agreement provides that as a result of paying money to BRC as capital contributions, SDC would receive a limited partnership interest in BRC upon the terms and conditions in the Subscription Agreement and in the Limited Partnership Agreement of BRC.

The Bond

[23] When Mr. Shlien was conducting due diligence on BRC, he was also looking to obtain insurance coverage for SureFire funds he was managing (as the principal of 8569606, the general partner of the limited partnerships), including SureFire FX Trading, LP. and, later, SDC.

[24] Mr. Shlien completed an application for coverage on a form used by another insurer. This application form was later provided to and accepted by Berkshire in connection with 8569606's application for coverage. In the application form, 8569606 sought pricing for a number of categories of coverages.

[25] One category of loss by the SureFire funds for which Mr. Shlien was seeking insurance coverage was loss resulting from theft or fraud by underlying investment funds or subadvisors. In the application form, one question to be completed by the applicant is "Why Insurance". In response to this question, Mr. Shlien responded:

> We are tying (sic) to add value to investors that want to invest through our Fund of Funds structure instead of allocating directly into the Underlying Managers. We believe that by adding insurance against fraud from our underlying managers, employees or by Opus as our 3rd party administrator, we are adding a layer of comfort that our investors will appreciate.

[26] Over a period of months from September 2018 to February 21, 2019, Gallagher, representing Mr. Shlien and the SureFire entities as their insurance broker, engaged in communications with Berkshire about the application for insurance coverage.

[27] The Bond, as issued, was provided by Berkshire to Gallagher on January 9, 2019. Gallagher solicited, negotiated and procured the Bond on behalf of SDC and the other SureFire entities.

[28] Berkshire issued three endorsements, called Riders, that made changes to the Bond effective February 26, 2019. Under Rider 11, the liability limits under the Bond were increased. Under Rider 12, a number of SureFire entities, including SDC, were added as a named "Insured". Under Rider 13, the definition of "Subsidiary" in the Bond was changed. BRC was a "Subsidiary", but only with respect to its operations or activities on behalf of any of the SureFire funds. Under Rider 13, section 9 of the Bond (Other Insurance or

Indemnity) was replaced, although the wording did not change from Rider 10 which formed part of the Bond as issued.

The SureFire and Bluestone Capital Management Relationship

[29] Mr. Shlien was introduced to Brian Shevland, the CEO of Bluestone Capital Management ("Bluestone"), as a reference when he was conducting due diligence on BRC. Bluestone is an asset management firm. In 2018 and 2019, Bluestone had $2.9 billion to $3 billion USD in assets under management.

[30] Mr. Shevland created the "A Funds", which consisted of three investment vehicles in Bluestone: Aalii Fund, LP, Aalii Fund, LP - Absolute Returns, and Alpha Capital Partners, LP.

[31] Between September 8, 2016 and May 3, 2018, the A Funds paid a total of $26,730,000 USD to BRC as capital contributions.

[32] Mr. Shevland and Mr. Shlien began discussions to transfer the A Funds interests in BRC to SDC in December 2018. They understood that such a transaction would be beneficial to SDC because (a) its capital balance in BRC would approach $50 million USD which, under the agreement that Mr. Shlien had negotiated with Ms. Smith, would result in a substantial fee reduction, and (b) SDC's expenses would be divided across a broader base of investors. They understood that the transaction would benefit Bluestone and the A Funds because they would benefit from the fee reduction that Mr. Shlien had negotiated with BRC (Bluestone had been unable to negotiate a fee reduction with BRC) and because Bluestone and the A Funds, as investors in SDC, would benefit from coverage under the Bond.

[33] The fund administrators for SDC and for Bluestone recommended that the interest of the A Funds in BRC be transferred to SDC by way of an "in-kind" transfer (a transfer of an asset into a fund without the need to liquidate any securities).

[34] On or about February 27, 2019, the full balance of the interests of the A Funds in BRC was transferred to SDC pursuant to two written letters signed by Mr. Shevland on behalf of the A Funds. Brenda Smith signed the transfer documents as the authorized representative for BRC.

Discovery of Brenda Smith's fraudulent activities

[35] In March 2019 Mr. Shlien received a letter from Ms. Smith's attorneys that included allegations against SDC including that the SureFire entities have engaged in solicitation and related unlawful activities that have damaged BRC. This caused concerns for Mr. Shlien who, shortly after receiving the letter, decided to redeem out of the BRC fund. BRC advised that it agreed to process SDC's redemption request and that the effective redemption date would be April 30, 2019, with the wire going out on May 15, 2019.

[36] The date of May 15, 2019 came, but SDC did not receive any wire transfer of funds. SDC commenced an arbitration against BRC. In the arbitration, BRC was ordered to deliver, among other things, a list of its assets. In July 2019, when BRC delivered a list of assets

dated June 30, 2019, Mr. Shlien and Mr. Shevland suspected that Ms. Smith had engaged in a fraud.

[37] Criminal proceedings were brought in the United States against Brenda Smith and others. On September 9, 2021, Ms. Smith pleaded guilty to a one count of securities fraud in the U.S. District Court. Through the Indictment, it was established that Ms. Smith misrepresented to investors that she would invest funds provided to BRC in particular trading strategies that she was optimally situated to execute. Instead of investing the money as promised, Ms. Smith diverted tens of millions of dollars of funds provided by investors out of BRC for purposes inconsistent with the trading strategies, including for personal use and to pay out millions of dollars to other investors.

SureFire claim under Bond

[38] On July 11, 2019, Mr. Shlien formally advised Berkshire that there was a potential claim under the Bond. Mr. Shlien submitted a proof of loss on behalf of SDC to Berkshire on September 27, 2019.

[39] In the proof of loss, the total amount of loss is stated to be $46,598,676.84 USD and/or the market value of the investments in BRC, whichever is greater. In the proof of loss, SDC states that the facts giving rise to the losses are set out in additional documents marked as exhibits to the proof of loss.

ANALYSIS

[40] The main issues in this action are whether one or more of the Insuring Agreements in the Bond covers SDC's loss and, if so, the amount of the loss sustained by SDC for which it is entitled to be indemnified under the Bond.

Interpretation of insurance policies

[41] In *Ledcor Construction Ltd. v. Northbridge Indemnity Insurance Co.*, 2016 SCC 37, the Supreme Court of Canada reviewed the governing principles of interpretation applicable to insurance policies. The Court confirmed that the primary interpretive principle is that where the language of the insurance policy is unambiguous, effect should be given to that clear language, reading the contract as a whole.

[42] Where the policy's language is ambiguous, general rules of contract construction must be employed to resolve that ambiguity. These rules include that the interpretation should be consistent with the reasonable expectations of the parties, as long as that interpretation is supported by the language of the policy; it should not give rise to results that are unrealistic or that the parties would not have contemplated in the commercial atmosphere in which the insurance policy was contracted, and it should be consistent with the interpretations of similar insurance policies.

[43] Only if ambiguity still remains after these principles are applied can the *contra proferentem* rule be employed to construe the policy against the insured. A corollary of this rule is that

coverage provisions insurance policies are interpreted broadly, and exclusion clauses narrowly.

[44] The insured has the onus of first establishing that the loss claimed falls within the initial grant of coverage. The onus then shifts to the insurer to establish that one of the exclusions to coverage applies. If the insurer is successful at this stage, the onus then shifts back to the insured to prove that an exception to the exclusion applies: *Ledcor*, at para. 52.

[45] In *Creston Moly Corp. v. Sattva Capital Corp*., 2014 SCC 53, at para. 47, Rothstein J., writing for the Court, held:

> … the interpretation of contracts has evolved towards a practical, common-sense approach not dominated by technical rules of construction. The overriding concern is to determine "the intent of the parties and the scope of their understanding" [citations omitted]. To do so, a decision-maker must read the contract as a whole, giving the words used their ordinary and grammatical meaning, consistent with the surrounding circumstances known to the parties at the time of formation of the contract. Consideration of surrounding circumstances recognizes that ascertaining contractual intention can be difficult when looking at words on their own, because words alone do not have an immutable or absolute meaning:
>
> > No contracts are made in a vacuum: there is always a setting in which they have to be placed. … In a commercial contract it is certainly right that the court should know the commercial purpose of the contract and this in turn presupposes knowledge of the genesis of the transaction, the background, the context, the market in which the parties are operating.
>
> (*Reardon Smith Line*, at p. 574, per Lord Wilberforce)

[46] In *Sattva*, Rothstein J., at paras. 57-58, addressed the role of surrounding circumstances in contractual interpretation and the nature of the evidence that can be considered:

> While the surrounding circumstances will be considered in interpreting the terms of the contract, they must never be allowed to overwhelm the words of that agreement [citations omitted]. The goal of examining such evidence is to deepen a decision-maker's understanding of the mutual and objective intentions of the parties as expressed in the words of the contract. The interpretation of a written contractual provision must always be grounded in the text and read in light of the entire contract [citation omitted]. While the surrounding circumstances are relied upon in the interpretive process, courts cannot use them to deviate from the text such that the court effectively creates a new agreement [citation omitted].
>
> The nature of the evidence that can be relied upon under the rubric of "surrounding circumstances" will necessarily vary from case to

> case. It does, however, have its limits. It should consist only of objective evidence of the background facts at the time of the execution of the contract [citation omitted], that is, knowledge that was or reasonably ought to have been within the knowledge of both parties at or before the date of contracting. Subject to these requirements and the parol evidence rule discussed below, this includes, in the words of Lord Hoffmann, "absolutely anything which would have affected the way in which the language of the document would have been understood by a reasonable man" [citation omitted]. Whether something was or reasonably ought to have been within the common knowledge of the parties at the time of execution of the contract is a question of fact.

[47] In *Onex Corp. v. American Home Assurance*, 2015 ONCA 573, at paras. 100-108, the Court stated the principles that apply to the interpretation of insurance polices. One of these principles is that the terms of the policy must be examined in light of the surrounding circumstances in order to determine the intent of the parties and the scope of their understanding. It is important to distinguish the factual matrix from extrinsic evidence that is admissible to resolve an ambiguity. The factual matrix extends to the genesis of the agreement, its purpose, and the commercial context in which the agreement was made. Where the language of an insurance policy is found to be ambiguous, the court will rely on general rules of contract construction. Where there is ambiguity in the sense that a phrase is capable of bearing two equally reasonable interpretations, the court may consider extrinsic evidence and the applicability of the *contra proferentum* rule. Evidence of the parties' subjective views of what was intended by the agreement is not admissible to resolve the ambiguity.

Does SFC have coverage for its loss under Insuring Agreement (A)(1)?

[48] I first address SDC's claim for coverage under Insuring Agreement (A)(1) of the Bond.

[49] Insuring Agreement (A)(1) reads that the Underwriter agrees to indemnify the Insured for:

> Loss resulting directly from dishonest or fraudulent acts, other than stated in (A)(2) below, committed by an **Employee** acting alone or in collusion with others.
>
> Such dishonest or fraudulent acts must be committed by the **Employee** with the intent:
>
> (a) to cause the Insured to sustain such loss; or
> (b) to obtain improper financial benefit for the **Employee** or other natural person acting in collusion with such **Employee**.

[50] Section 1(g) of the Conditions and Limitations of the Bond reads, in part, that as used in the Bond, "Employee" means:

> (1) an officer of the Insured while performing the duty of an **Employee**,
>
> (2) a natural person in the service of the Insured at any of the **Insured's** offices or premises covered hereunder whom the Insured compensates directly by salary or commissions and whom the Insured has the right to direct and control while performing services for the Insured.
> ...

[51] The definition of "Employee" also describes other persons in other sub-paragraphs.

[52] The Bond as issued for the period from January 1, 2019 to January 1, 2020, pursuant to Rider 9, names five SureFire entities (not including SDC) as Insureds.

[53] Rider 12 became effective February 26, 2019 and amends the Bond by deleting Rider 9 and replacing it with language naming eight SureFire entities as Insureds. One of these entities is SDC which, as a result of the addition of Rider 12, became a named Insured effective February 26, 2019.

[54] Rider 13 was also added effective February 26, 2019. Rider 13 repeats the language from Rider 10 that BRC is a "Subsidiary" (with two other named entities), "but only with respects to their operations or activities on behalf of any of the 'SureFire' funds". Rider 13 reads that the "OTHER INSURANCE OR INDEMNITY" provision in section 9 of the Bond is replaced in Rider 13 with the following language:

> Coverage afforded hereunder shall apply only as excess over any valid and collectible insurance or indemnity obtained by the Insured or any **Subsidiary**, or by one other than the Insured on **Property** subject to exclusion (q) or by a **Transportation Company**, or by another entity on whose premises the loss occurred or which employed the person causing the loss or the messenger conveying the **Property** involved.

[55] SDC submits that Rider 13, when it is read with the Bond as a whole, is clear that SDC is covered for losses from fraud or theft by underlying managers, including BRC, committed in the course of their operations or activities on behalf of SDC. SDC submits that the sole purpose of Rider 13 was to broaden coverage under the Bond in order to provide coverage for loss by SureFire entities resulting directly from fraud or theft committed by SDC's underlying managers, including BRC. SDC does not assert that BRC is an insured entity under the Bond.

[56] SDC submits that this interpretation of the Bond is consistent with the main purpose of adding BRC as a "Subsidiary". SDC submits that to interpret the Bond such that it does not cover loss to SDC resulting from a fraudulent Ponzi scheme committed by Brenda Smith while she was an officer of BRC (1) would virtually nullify the coverage provided by the

Bond in respect of BRC, and (2) would be contrary to the reasonable expectations of the parties as to the coverage purchased.

[57] Berkshire submits that there is a distinction in the Bond between named "Insureds" and other entities that are "insureds" under the Bond. Berkshire submits that Rider 13 adds BRC, a "Subsidiary", as an insured entity under the Bond with the same coverage as other insureds, including named "Insureds". Berkshire denies that the Bond can be read to cover a loss sustained by SDC resulting from dishonest or fraudulent acts committed by Brenda Smith, an officer of BRC, a Subsidiary.

[58] The Bond, in section E of the General Agreements under the heading "Joint Insured", reads:

> (E) If two or more Insureds are covered under this bond, the first named Insured shall act for all Insureds. Payment by the Underwriter to first named Insured of loss sustained by any Insured shall fully release the Underwriter on account of such loss. If the first named Insured ceases to be covered under this bond, the Insured next named shall thereafter be considered as the first named Insured. Knowledge possessed or discovery made by any insured shall constitute knowledge or discovery by all insureds for all purposes of this bond. The liability of the Underwriter for loss or losses sustained by all insureds shall not exceed the amount for which the Underwriter would have been liable had all such loss or losses been sustained by one Insured.

[59] The language of the "Joint Insured" provision in the Bond shows that there is a distinction drawn between a named "Insured", a defined term, and an "insured", a term which is not defined. The words are used separately in this provision and the parties are presumed to have intended that they have different meanings. This provision in the Bond supports Berkshire's submission that an entity can be an "insured" entity under the Bond where it is not a named "Insured".

[60] The definition of "Subsidiary" in the Bond does not expressly state that a Subsidiary is an insured entity. The defined term "Subsidiary" is used in section 9 of the Bond under the heading "Conditions and Limitations (Other Insurance or Indemnity)", as amended by Rider 13 (to add the words "or any **Subsidiary**"). Section 9, as amended, reads:

> Coverage afforded hereunder shall apply only as excess over any valid and collectible insurance or indemnity obtained by the Insured or any **Subsidiary**, or by one other than the Insured on **Property** subject to exclusion (q) or by a **Transportation Company**, or by another entity on whose premises the loss occurred or which employed the person causing the loss or the messenger conveying the **Property** involved.

[61] This condition and limitation of the Bond reflects recognition that there is coverage under the Bond for a "Subsidiary", with the limitation that such coverage shall apply only as excess over any valid and collectible insurance or indemnity obtained by the Insured or any Subsidiary. If a Subsidiary was not an insured entity with coverage under the Bond, there would be no need to specify that coverage under the Bond shall apply only as excess coverage over coverage obtained by the Insured or any Subsidiary. The language of this provision supports the interpretation of the Bond advanced by Berkshire, that a Subsidiary has coverage under the Bond as an "insured".

[62] Under the heading "Conditions and Limitations", section 10 of the Bond reads:

> This bond shall apply to loss of Property (1) owned by the Insured, (2) held by the Insured in any capacity, or (3) for which the Insured is legally liable. This bond shall be for the sole use and benefit of the Insured named in the Declarations.

[63] Section 10 does not refer to an "insured" entity but only to the "Insured" named in the Declarations. To support the interpretation that Berkshire advances, the word "Insured" would have to be read, when considered with the Bond as a whole and having regard to surrounding circumstances, as including additional insured entities.

[64] I also consider evidence of surrounding circumstances known to SDC and Berkshire on January 1, 2019, when the Bond became effective, and on February 26, 2019 when SDC was added as an Insured and when Rider 13 became effective. SDC submits that the surrounding circumstances, including communications between Berkshire with SDC (directly or through its agent, Gallagher), inform the reasonable expectations of the parties and support the interpretation of the Bond that it advances.

[65] Both SDC and Berkshire rely on communications between Gallagher (through its representative, Mark Morency), SDC's insurance broker and its agent, and Berkshire (through its representative, Andrew Knight) in relation to language in Rider 13 naming BRC as a "Subsidiary" and the proper interpretation to be given to the coverage provisions in the Bond.

[66] Evidence of surrounding circumstances includes anything which would have affected the way in which the language of the Bond would have been understood by a reasonable person: *Sattva*, at para. 58. This includes evidence bearing on the genesis of the Bond, including Rider 13, its purpose, and the commercial context in which it was made. It does not include evidence of the subjective views of the parties of what was intended by the Bond.

[67] There was extensive evidence at the trial in respect of these communications. Many emails were put into evidence through a Joint Document Book. Mr. Shlien testified about his communications with Mr. Morency of Gallagher and two telephone discussions in which he participated with Mr. Gallagher and Mr. Knight. Mr. Knight testified about his communications with Mr. Morency and about the two telephone calls. Another employee

of Gallagher who worked with Mr. Morency, Miranda Ng, also testified about one of the telephone calls. Mr. Morency did not testify at the trial.

[68] I do not consider the emails or telephone communications between Mr. Shlien and Mr. Morency to be relevant or admissible as evidence of surrounding circumstances. An example of this type of evidence is Mr. Shlien's evidence that he spoke with Mr. Morency on a number of occasions and specifically said to him that he was seeking insurance coverage for losses sustained by SureFire entities resulting from a Ponzi scheme by one of SDC's underlying fund managers.

[69] Mr. Morency was the insurance broker for Mr. Shlien and the SureFire entities. In its dealings with Berkshire, Gallagher was the agent of Mr. Shlien and the SureFire entities. The communications between Mr. Shlien and Mr. Morency may be evidence showing Mr. Shlien's subjective intent with respect to the meaning to be given to the Bond (with the addition of Rider 13) but, in my view, these communications do not qualify as objective evidence of surrounding circumstances known to both SDC and Berkshire, or that reasonably ought to have been within their knowledge, that is admissible to assist in the interpretation of the Bond.

[70] I consider the email communications between Mr. Morency (representing SDC as its agent) and Mr. Knight as objective evidence of surrounding circumstances known to SDC and Berkshire on February 26, 2019, when SDC became a named Insured and when Rider 13 was added. In considering these communications, I am cautious not to rely on this evidence to the extent that they show the subjective intentions of SDC or Berkshire with respect to how the Bond should be interpreted. I do not consider these communications as negotiations *per se*, but as objective evidence of what Mr. Shlien (through Mr. Morency) told Berkshire he was seeking in relation to BRC under the Bond and what Berkshire told Mr. Shlien in response.

[71] I am mindful that drawing a distinction between, on the one hand, the use of such pre-agreement communications as evidence of surrounding circumstances that will deepen the decision-maker's understanding of the objective intentions of the parties when the agreement was made and, on the other hand, the use of such evidence to show how the parties subjectively understood what an agreement means and how it should be interpreted, can be difficult. In this regard, I note that in *Corner Brook (City) v. Bailey*, 2021 SCC 29 the Supreme Court of Canada observed, at para. 56, that the traditional rule that evidence of negotiations is inadmissible when interpreting a contract has been held in *Resolute FP Canada Inc. v. Ontario (Attorney General)*, 2019 SCC 60 to be one that "sits uneasily" next to the approach from *Sattva* that directs courts to consider the surrounding circumstances in interpreting a contract. In *Corner Brook*, the Supreme Court of Canada left for another day the question of whether, and if so, in what circumstances, negotiations will be admissible in interpreting a contract.

[72] I begin with an email chain beginning September 7, 2018 with Mr. Morency's email to Mr. Knight. In this email, Mr. Morency inquires about Berkshire's interest in a "form 14 bond" for a hedge fund manager. On September 26, 2018, Mr. Morency requests coverage for "a specific external fund manager". He states: "It is restrictive coverage in that the external

fund manager would have to commit fraud and that fraud would have to specifically affect the Surefire fund."

[73] In response to this request for coverage for an external fund manager, Mr. Knight responds on September 26, 2018: "We can add the entity to the policy as an insured entity, thus they would have the same coverage as SureFire but we could potentially limit to only their operations on behalf of the Fund. Not sure if that would work."

[74] On September 28, 2018, Mr. Knight writes to Mr. Morency attaching revised terms of coverage proposing to add Virgil (another of SureFire's sub-advisors, like BRC) and confirming that the coverage for Virgil would be limited to the related SureFire entities and excess of any other fidelity insurance they carry. Mr. Knight addressed the fraud scenario involving Virgil and wrote:

> Also, keep in mind that the situation of a fraud scenario perpetrated by Virgil that was a) related to bad or poorly performing investments or exchanges, b) fraudulent securities or investments would not be a fidelity loss under this policy. However, instances of fraud which involved the theft of client/SureFire monies or securities by Virgil would be. Just want to make sure that is understood.

[75] On September 28, 2018, in response to this email, Mr. Morency wrote to Mr. Knight and advised, "Yes, the terms make sense. I will check with the client about checking on Virgil's insurance".

[76] On September 30, 2018, Mr. Morency writes to Mr. Knight with questions from Mr. Shlien. One of these questions concerned Virgil. Mr. Shlien asks whether the policy covers theft and fraud perpetrated by Virgil directly. In his email to Mr. Knight, Mr. Morency asks whether it is possible to broaden the coverage as Mr. Shlien requests.

[77] On October 11, 2018, Mr. Knight advises Mr. Morency that he is uneasy extending coverage to Virgil because Virgil does not have its own primary insurance coverage. Mr. Knight advises that typically sub-advisors carry their own coverage that would extend to their involvement or exposure to the theft or fraud. Mr. Knight declined to offer coverage to sub-advisors.

[78] On November 5, 2018, Mr. Morency told Mr. Knight that Virgil will purchase insurance coverage of $10 million and that he would provide prospectuses for all the funds in the next few days. Mr. Knight responds: "We can definitely sit excess of that and name Virgil".

[79] On November 8, 2018, Mr. Morency advises Mr. Knight that Mr. Shlien would like coverage at the parent level (for all their funds) and "an endorsement extending to as many of the external fund managers as you'd be willing to add". He requests a proposal from Berkshire.

[80] On November 10, 2018, Berkshire provides a proposal for insurance to Mr. Morency at Gallagher. The parent company named in the proposal was 8569606. The proposal proposes a "manuscript" endorsement for "Added Entity Virgil Capital (Excess) – FX

Trading Fund". In the covering email, Mr. Knight writes: "We have included a manuscript to name Virgil under the policy with respects to their work on behalf of FX Trading. We could look to add other managers in the future on a case by case basis".

[81] On November 20, 2018, Mr. Morency asks Mr. Knight some questions and asks to add BRC in addition to Virgil, saying that it has a "form 14 bond in place". The email to Mr. Knight forwards an email to Mr. Morency from Mr. Shlien in which he asks for the endorsement to include "theft/fraud by the sub-advisors into which SureFire's investment funds invests its capital". Mr. Knight responds the same day and asks questions about the new entity including "the bond limit they carry". Mr. Morency forwards an email from Mr. Shlien with information about the bond limit (held by an "associated company" with a standard bond of $120,000). Mr. Knight confirms that Berkshire would endorse the policy to cover BRC as a sub-advisor to SDC.

[82] On November 22, 2018, Gallagher provides formal binding instructions to Berkshire. The instructions request that the manuscript endorsement names each of the sub-advisors Virgil and BRC as an "Added Entity". Berkshire sends a binder of insurance to Gallagher on November 23, 2018 showing that Virgil and BRC would be "Added entities" with respect to SureFire operations for excess coverage only.

[83] On December 5, 2018, Gallagher (through Miranda Ng who worked with Mr. Morency) requests a written explanation of the intent of coverage and how the policy includes coverage for the underlying funds. Mr. Knight responds that Berkshire does not provide such documents and typically "lets our wording stand".

[84] On December 11, 2018, a telephone conference was held with Mr. Shlien, Mr. Morency, Miranda Ng, and Mr. Knight.

[85] Mr. Shlien testified that the participants in the call discussed the nature of the insurance and Mr. Knight confirmed that Mr. Shlien was getting coverage for theft and fraud by the underlying managers. Mr. Shlien testified that they discussed mechanics about how things would work if there was a loss. Mr. Shlien testified that the term "Ponzi scheme" did not come up on the call. Mr. Knight did not give specific examples of what types of fraud would be covered or not covered. The conversation was a short one.

[86] Mr. Knight's evidence is that they talked about the basics of coverage for this product to address any misunderstandings. The discussion involved general themes. Mr. Knight agreed that he discussed that various elements of fraud and theft by SureFire's underlying managers could be covered. He testified that there was no discussion about Ponzi schemes.

[87] Ms. Ng testified that she attended two telephone conference calls as an observer. With respect to the December 11, 2018 call, she testified that she recalls Mr. Shlien asking questions related to potential claims situations that may be covered given the highly technical nature of the policy and whether this situation or that situation would be covered or not. She did not recall any particular claims situations described by Mr. Shlien. Mr. Ng was asked in her evidence in chief what her understanding was of the coverage that SureFire was looking for from Gallagher. She responded that the main coverage was if

there was wrongdoing by employees. She said a lot of the conversations in this call went over her head. Ms. Ng testified that Mr. Knight answered questions about coverage and gave general examples of claims and said that every claim is unique and the circumstances of the claim would determine if and how a claim is covered. Ms. Ng was not asked about the later call.

[88] On January 9, 2019, Mr. Knight sends the Bond to Gallagher.

[89] On February 19, 2019, Mr. Morency writes to Mr. Knight to request confirmation that what SureFire is representing to its investors about coverage under the bond is correct. He asks:

> On the coverage for Virgil and Broadreach, if either of these are fraudulent (let's say a Ponzi scheme), and this causes loss to SureFire, then there would be coverage, correct?

[90] In his email, Mr. Morency provides four scenarios including: "Virgil turns out to be a Ponzi scheme and the Virgil principles (sic) were committing fraud all along, unbeknownst to SureFire and SureFire takes a loss - this would be covered?"

[91] Mr. Knight responds on February 21, 2019 at 9:38 a.m. and he addresses whether there would be coverage for a SureFire entity which sustained loss where an underlying fund manager is fraudulent and engaged in a Ponzi scheme:

> If the underlying managers or their funds are fraudulent or performed poorly and it causes a loss to SureFire (and/or their investors) that would be more than likely be an E&O. The investors would sue because it would have been alleged that SureFire hadn't done their due diligence on the underlying asset/manager. Investors would likely take action and coverage that would respond would be driven by that third party (E&O) suit. The bond would typically cover employee theft, wire fraud, etc and in my experience those investors affected by Ponzi schemes have had a long road to recovery under insurance policies. In my experience, Ponzi scheme start at the top and typically the facts known to those individuals are imputed to the organization and/or void the policy. I don't believe any feeder funds that experienced fraud losses under Madoff, for example, had covered fidelity claims.

[92] Mr. Knight advises in this email, in response to the scenario posited by Mr. Morency, that "[i]t would be unlikely that a scenario involving a Ponzi that originated at the top would find coverage under a fidelity policy. The primary bond for Virgil would respond first, but in all likelihood might have been rescinded due to untruths, knowledge, etc.". Mr. Knight offers to have a call with Mr. Morency's client to clear up any points.

[93] Upon receipt of this email, Mr. Morency asks Mr. Knight whether he could talk to Mr. Shlien. A telephone conference call took place among Mr. Shlien, Mr. Morency, Mr. Knight, and Ms. Ng approximately one hour after Mr. Knight's email.

[94] Mr. Shlien testified that he was not provided with a copy of Mr. Knight's February 21, 2019 email sent at 9:38 a.m. until after this litigation started.

[95] Mr. Shlien testified on cross-examination that the call took place because Mr. Morency offered to arrange a call directly with the underwriter and he accepted. He testified that he remembers that the call took place but he does not recall the details of what was discussed. Mr. Shlien testified that he is sure that no one on the call said that loss from a Ponzi scheme would not be covered by the Bond because such advice would have fundamentally changed what he had been told previously and would have contradicted what he was telling his investors, a matter he took very seriously. Mr. Shlien took no notes.

[96] Mr. Knight testified that he is sure that he discussed coverage for Ponzi schemes on the call because he had just sent an email addressing this question. Mr. Knight testified that he does not recall the details of the call, but he is sure he did not say Ponzi schemes would be covered.

[97] Following the call, a few hours later, Mr. Morency sends an email to Mr. Knight asking for "a confirmation statement to the effect that SureFire is covered for theft and fraud under the bond wording they now have". Mr. Morency responds:

> Hi Mark, yes, the basis for the fidelity bond is to cover theft and fraudulent acts of employees and third parties as it pertains to property of the insured and that with which is the insured is legally liable. Insured entities under this policy include SureFire/its funds and by endt we have added Virgil/Broad Reach in their capacity as investment managers on behalf of SureFire. All bonds, including this policy are written on a named peril (vs all peril) basis thus each scenario should be evaluated on its individual merits when looking for coverage. As discussed we've built a Canadian form which is very competitive in the marketplace and as endorsed in this particular case, is broader than what is often available amongst our peers.

[98] The email sent by Mr. Knight after the February 21 call confirms that there is coverage for Surefire for theft and fraud under the wording they have.

[99] The evidence shows that Mr. Shlien was seeking coverage from Berkshire for the SureFire entities for loss resulting from fraud and theft by BRC. Before his February 19, 2019 email, Mr. Morency did not use the term "Ponzi scheme" in relation to sub-advisors in his emails to Mr. Knight to describe the coverage that Mr. Shlien was seeking. When Mr. Knight informed Mr. Morency on September 28, 2018 that a loss from fraudulent securities or investments perpetrated by a sub-advisor would not be covered, Mr. Morency responded that this "makes sense". However, Mr. Morency's email to Mr. Knight on February 19, 2019 makes it clear to Mr. Knight on that day that Mr. Shlien is, in fact, seeking coverage for loss to SDC resulting from a Ponzi scheme perpetrated by a sub-advisor.

[100] The evidence does not, however, show that Mr. Knight told Mr. Morency, or Mr. Shlien, that the Bond would provide coverage for SDC for theft and fraud by the directing mind of a sub-advisor. To the contrary, on February 21, 2019, Mr. Knight responded to Mr. Morency's request about coverage for loss resulting from a Ponzi scheme by stating that coverage for such a loss under a fidelity policy would be unlikely.

[101] Mr. Shlien testified that when he saw the email from Mr. Knight for the first time during this litigation, he was very angry because the position taken by Mr. Knight contradicted what he had been previously told and, to him, it seemed that Gallagher and Berkshire understood that a loss resulting from dishonesty and fraud by BRC committed by its principals through, for example, a Ponzi scheme, would not be covered by the Bond, yet they did not share this information with him.

[102] When they testified, neither Mr. Shlien nor Mr. Knight recalled what was specifically discussed on the February 26, 2019 call. Although Mr. Knight is confident that he discussed coverage for a Ponzi scheme, his recollection was informed by the fact that his email addressing such coverage had just been sent. Mr. Shlien did not recall what was said, but his testimony that coverage for a Ponzi scheme was not discussed was informed by his state of mind based on prior communications.

[103] Mr. Morency did not testify. Ms. Ng testified, but she was not asked about this call. I am unable to make findings about what was specifically said or not said on the call, except that I find, based on Mr. Knight's evidence that the call took place in the context of his having just sent his email, that Mr. Knight did not contradict the information given in his email about coverage for a Ponzi scheme. Mr. Knight testified that he did not say in the call that a Ponzi scheme would be covered and I accept his evidence.

[104] The email sent by Mr. Knight to Mr. Morency in the morning of February 26, 2019 communicated that coverage for a Ponzi scheme under a fidelity bond would be unlikely and that investors affected by a Ponzi scheme have had "a long road to recovery" under insurance policies. This email was sent to SDC's agent, Gallagher. If Mr. Shlien became angry when he first learned of this email during this litigation, his anger was properly directed to Gallagher and not to Berkshire.

[105] With the evidence of surrounding circumstances in mind, I return to the language of the Bond.

[106] The form of the Bond, before and after inclusion of Rider 13 which deleted and replaced the definition of "Subsidiary", included within the meaning of "Subsidiary" an organization created during the bond period of which more than 50% of the voting rights for election of directors is owned or controlled by the Insured directly or through one or more of its subsidiaries. This language shows that a Subsidiary could be an organization which is controlled by a named Insured that is not a named Insured and that was created during the term of the Bond. The parties included this language and must have intended that it would have effect. I read this language to mean that a Subsidiary of a named Insured, even one created after the Bond became effective, would have insurance coverage under

the Bond. This is the only reasonable interpretation to be given to this language in the context of the Bond read as a whole.

[107] Rider 13 assigns a meaning to the word "Subsidiary" that includes BRC as a Subsidiary. Section 9 of the Bond, as modified by Rider 13, provides that coverage afforded under the Bond applies only as excess over any valid and collectible insurance obtained by the Insured or any Subsidiary. This language shows that a Subsidiary is not a named "Insured", but that it is an insured entity that, like another Subsidiary created during the bond period that is controlled by a named Insured, is covered (as excess coverage over other valid insurance) for loss by the Subsidiary resulting from perils insured against in the Bond.

[108] This interpretation is consistent with evidence of surrounding circumstances including Mr. Knight's email on September 26, 2018 where, in response to Mr. Morency's request for coverage for an external fund manager, he writes "[w]e can add the entity to the policy as an insured entity". On November 5, 2018, after Mr. Morency advises that Virgil (another external advisor) has primary fidelity coverage, Mr. Knight responds "[w]e can definitely sit excess of that and name Virgil". On November 22, 2018, Gallagher provides binding instructions and requests a manuscript endorsement that names sub-advisors as an "Added Entity".

[109] I conclude that the Bond should be interpreted such that BRC, as a "Subsidiary", is an "insured" entity under the Bond, in the same way that an organization created during the bond period that is controlled, directly or indirectly, by a named Insured, would have coverage under the Bond.

[110] Insuring Agreement (A)(1) provides for coverage for loss resulting directly from dishonest or fraudulent acts committed by an "Employee". The word "Employee" is defined in the Bond. An "Employee", in the relevant parts of the definition, means "an officer of the Insured while performing the duty of an Employee" and "a natural person in the service of the Insured at any of the Insured's offices or premises ... whom the Insured has the right to direct and control while performing services for the Insured". SDC does not assert that Brenda Smith was an "Employee" of SDC, a named Insured.

[111] Berkshire accepts that as a named "Insured" under the Bond, SDC is entitled to make a claim for indemnification for any loss sustained by BRC, as an insured entity, and resulting directly from dishonest or fraudulent acts committed by an "Employee" of BRC. Berkshire denies that if such a claim had been made under Insuring Agreement (A)(1), there would be coverage for BRC as an "insured" entity for fraud committed by Brenda Smith who, it contends, controlled BRC and was its alter ego.

[112] It is not necessary for me to decide whether, if BRC had made a claim for coverage for loss resulting from Ms. Smith Ponzi scheme, or if SDC, as a named Insured, had made such a claim on behalf of BRC, there would be coverage under the Bond. SDC does not seek coverage for a loss claimed by BRC.

[113] SDC's position is that BRC is not an insured entity under the Bond, but that the effect of naming BRC as a "Subsidiary" in Rider 13 with respect to its operations or activities on

behalf of the SureFire funds is that an additional peril was insured against, that is, peril from a dishonest or fraudulent act committed by an "Employee" of BRC. SCD submits that Insuring Agreement (A)(1) should be interpreted to provide coverage for the loss claimed by SDC resulting from this additional peril.

[114] When Rider 13 was added to the Bond, there were no changes to Insuring Agreement (A)(1) to add coverage for an additional peril. Mr. Shlien was represented by Gallagher, an insurance broker, when the Bond language was finalized. If the parties had intended to expand coverage under Insuring Agreement (A)(1) to provide for indemnification to SDC for losses resulting directly from dishonest or fraudulent acts committed by an "Employee" of BRC (a Subsidiary), they could have readily accomplished this objective by adding necessary language to change the coverage provided under Insuring Agreement (A)(1). This was not done.

[115] Contrary to the submission by SDC, an interpretation of the Bond that does not expand coverage under Insuring Agreement (A)(1) to provide for indemnification to SDC for losses resulting from dishonest or fraudulent acts committed by an "Employee" of a "Subsidiary" would not nullify the coverage provided by the Bond in respect of BRC. Coverage under the Bond would be expanded to provide for indemnification to BRC, as a Subsidiary and an additional insured, for its losses covered by the Insuring Agreements in the Bond, but only with respect to the operations or activities of BRC on behalf of any of the SureFire funds.

[116] I do not accept that in the circumstances that existed when the Bond was issued or when Rider 13 was added, either SDC (represented by Gallagher) or Berkshire reasonably expected that the Bond would cover loss to SDC resulting from a Ponzi scheme perpetrated by Brenda Smith as an officer of BRC. Such an interpretation should not be accepted, in any event, because it cannot be accommodated by the words of the Bond, specifically, the words of Insuring Agreement (A)(1).

[117] SDC has failed to establish that its loss fits within the initial grant of coverage in Insuring Agreement (A)(1).

[118] Both SDC and Berkshire made submissions about whether Brenda Smith should be considered to be the alter ego of BRC and various authorities were cited. These submissions addressed whether Ms. Smith should be considered an "Employee" of BRC within the meaning of this word in the Bond.

[119] Whether or not the Bond should be interpreted such that Brenda Smith is an "Employee" of BRC is not, in my view, a relevant consideration where no claim is made by or on behalf of BRC. This determination would only be relevant if a claim was made by or on behalf of BRC, as an insured, for coverage under the Bond for loss sustained by BRC resulting from dishonesty or fraud committed by Ms. Smith.

[120] In the authorities cited, the courts had to address a claim by an insured entity where the directing mind of the insured entity had committed the dishonest act which resulted in a loss to the insured entity for which indemnification was sought. For example, SDC cites

U.S. cases where the definition of "Employee" of an entity in the policy included an "officer" without limitation to whether the corporation had the right to govern or control such officer and the "alter ego" defence failed. See *SEC v. Credit Bancorp, Ltd.*, 147 F. Supp. 2d 238 (2001); *Federal Deposit Ins. Corp. v. New Hampshire Ins. Co.*, 953 F. 2d 478 (1991); *F.D.I.C. v. Kansas Banker's Sur. Co*., 17 F. 3d 1436.

[121] In a Canadian case, *Clarkson Co. v. Canadian Indemnity Co*., 1979 CarswellOnt 219 (ONSC), at paras. 99-118; aff'd 1981 CanLII 3006 (ONCA), the definition of "Employee" included "officers" (without limiting language) and, at para. 118, the trial judge found that the insured corporation was inextricably involved in the dishonest acts complained of, for its own interest and profit, and cannot complain to its insurer. The claim for coverage was denied.

[122] These cases involved different considerations than those that are before me. Here, where no claim is made for a loss sustained by BRC, it is not necessary for me to decide whether BRC's directing mind, Ms. Smith, should be treated as an "Employee" of BRC such that there would be coverage for BRC's loss.

Does SDC have coverage for the loss claimed under Insuring Agreement (A)(4)?

[123] SDC submits that its loss is also covered by the Bond under Insuring Agreement (A)(4). This Insuring Agreement provides that the Underwriter agrees to indemnify the Insured for:

> Loss resulting directly from the **Theft** of **Customer Property** by a **Registered Representative**.

[124] In the Bond:

> (t) **Registered Representative** means any registered representative, registered principal, registered investment advisor or other registered person of the Insured.
>
> (e) **Customer** means, solely with respect to Insuring Agreement A(4) any natural person for whom the professional services of the Insured or the **Registered Representative** have been engaged, as evidenced by the existence of any of the following documents at the time that the loss occurred:
>
> [list of documents]
>
> ...
>
> Absent the existence of at least one of the documents listed in (a) through (e) above, **Customer** shall also mean any natural person for whom the professional services of the Insured or the **Registered Representative** have been engaged, but only if the Insured is determined by a governing regulatory authority or finally adjudicated by a

> court or administrative proceeding of competent jurisdiction: (i) to have vicarious liability to such person, firm, corporation or association as its **Customer** in connection with the **Theft** of **Customer Property** of such person, firm, corporation or association; and (ii) an order, opinion, memorandum or similar document is issued by such regulatory authority, court or administrative proceeding stating that the Insured is vicariously liable and/or is required to pay a sum to such person, firm, corporation or association as its **Customer** in connection with the **Theft** of **Customer Property** of such person, firm, corporation or association.
>
> (f) **Customer Property** means **Money** or securities of a **Customer**.
>
> (x) **Theft** means the larceny, embezzlement or other unlawful taking to the deprivation of a Customer.

[125] SDC submits that the Ponzi scheme perpetrated by Ms. Smith was a "Theft" of "Customer Property" by Ms. Smith, a "Registered Representative", to the deprivation of SDC's investors (limited partners of SDC) who were each a "Customer".

[126] SDC submits that a Customer does not need to be a natural person because the definition of "Customer", although referring to a "natural person", also refers to "such person, firm, corporation or association as its Customer". For the purpose of my analysis, I accept that the definition of "Customer" in the Bond is ambiguous in this respect and that the ambiguity should be resolved in favour of SDC, an Insured, such that a Customer could be a "person, firm, corporation or association".

[127] Berkshire submits that SDC did not sustain a loss resulting from a Theft of Customer Property because the funds diverted or stolen by Ms. Smith belonged to BRC and not to SDC or its investors.

Was Brenda Smith a "Registered Representative"?

[128] The evidence shows that Brenda Smith was registered with the U.S. Financial Industry Regulatory Authority ("FINRA") as a General Securities Representative. I accept that Ms. Smith was a Registered Representative within the meaning of this term in the Bond.

Was there a "Theft of Customer Property"?

[129] After completing due diligence on BRC, SDC transferred a total of $4,510,000 of money it had received from its investors to BRC in four installments. In consideration for these payments, SDC obtained a limited partnership interest in BRC.

[130] SDC relies on evidence of Ms. Smith's Indictment in criminal proceedings as proof of the underlying facts in relation to her fraud. The Indictment states that the goal of the scheme

to defraud was to fraudulently induce individuals and entities into investing money in BRC by making material misrepresentations and omissions. The Indictment states that instead of investing the money as represented, Ms. Smith diverted tens of millions of dollars of investor funds out of BRC for purposes inconsistent with the trading strategies she told investors BRC would follow, including for personal use and to pay out millions of dollars to other investors.

[131] SDC submits that it sustained a loss of Property resulting directly from Ms. Smith's false promises as soon as it wired money to BRC.

[132] In support of this submission, SDC relies on *International Nesmont Industrial Corp. v. Continental Insurance Co. of Canada*, 2002 BCCA 136. In that case, two officers of insured companies issued false invoices which were paid. The officers then used the payments to invest capital into the insured companies in exchange for shares. The insurer maintained that there was no loss because the money that was dishonestly taken was later returned to the insureds in exchange for shares which could be cancelled. The British Columbia Court of Appeal disagreed, and held that the loss contemplated by the insuring agreement occurred at the moment when the cheques were issued on the false invoices.

[133] The facts in *International Nesmont* are materially different from the facts at hand. In *International Nesmont*, the insureds paid money based on false invoices where no goods or services were provided. Upon payment, the insureds sustained a loss. In contrast, here, SDC made investments in BRC in exchange for limited partnership interests. So long as the money paid to BRC was maintained in BRC's account and not taken by Brenda Smith, the capital contributed by SDC was not lost.

[134] SDC also relies on *FDIC v. National Union Fire Insurance Company of Pittsburgh, PA*, 205 F. 3d 66 (2000) in support of this submission. In this case, the FDIC as receiver for a bank, the insured, sought coverage from the insurer under a fidelity bond for a loss caused by dishonest and fraudulent acts by an employee of the bank. A trustee of the bank knew that an employee of the construction manager of a real estate project financed by the bank was engaging in improper and illegal activities in relation to the project but he did not tell the bank. Later, the bank loaned more money to the real estate project and amounts in excess of the bond's limit were not repaid. The FDIC sought to recover the bank's losses under a fidelity bond issued by the insurer. The Court held that the evidence showed that the bank's trustee, an employee of the bank, committed dishonest acts within the meaning of the bond by failing to disclose fraudulent conduct that pertains to a loan. The Court addressed whether the bank's employee's conduct directly caused the loss, and held that the FDIC was entitled to recover under the bond because the FDIC showed that the bank would not have issued its second loan if it had known of the wrongdoing by the employee of the construction manager and it would not have suffered the loss.

[135] SDC submits that like the bank in the *FDIC* case, its loss was directly caused by Brenda Smith's fraudulent statements because were it not for her false statements, SDC would not have lost its investment in BRC.

[136] The insured's claim in the FDIC case was made under the equivalent insuring agreement to Insuring Agreement (A)(1). The analysis does not apply to a claim under Insuring Agreement (A)(4). The question with respect to SDC's claim for coverage for its loss under Insuring Agreement (A)(4) is not whether SDC would have placed money for investment with BRC if it had known, prior to doing so, that Brenda Smith's representations about BRC's investment strategies were false. The question is whether SDC has established that it sustained a loss resulting directly from Theft of Customer Property.

[137] I conclude that there was no loss resulting from Theft of Customer Property upon successful completion of the wire transfers. There could only be a loss when Brenda Smith fraudulently misused the money so transferred. The question that must be answered is whether SDC or its investors, had a property interest in money held by BRC when it was fraudulently stolen or diverted by Ms. Smith such that the money falls within the meaning of "Customer Property" as used in the Bond.

[138] SDC submits that the investors in SDC owned the money invested in SDC and the money SDC invested in BRC. SDC submits that as limited partners of SDC, the investors owned a share of SCD's investments in BRC. SDC contends that the Limited Partnership Agreement of BRC is clear that a limited partner owns a share of BRC's assets.

[139] The Limited Partnership Agreement of BRC was put into evidence at the trial. SDC relies on the italicised words in section 1.9(kk) which defines "Ownership Percentage":

> "Ownership Percentage" with respect to a Partner's Capital Account means the percentage computed by dividing a Partner's Capital Account Balance on a given date by the aggregate of all Partners' respective Capital Account Balance is on that date. *A Partner's Ownership Percentage determines his share of the Partnership's Asset Value at any given time.* The Ownership Percentage of a Partner on the day the Partner becomes a Partner of the Partnership shall be determined by dividing the amount of such Partner's Capital Contribution by the value of the Partnership's Net Asset Value, including unrealized gains and losses and the amount of such Partner's Capital Contribution. As applied only to the Limited Partners, "Ownership Percentage" means the percentage ownership interest of a Limited Partner in the Partnership computed by dividing the Limited Partner's Capital Account balance on a given day by the aggregate of all Limited Partners' respective Capital Account balances on that day. (emphasis added)

[140] In the BRC Limited Partnership Agreement, the term "Net Asset Value" or "NAV" as that term is applied to BRC will be the U.S. dollar amount derived by subtracting (i) the liabilities of the Partnership from (ii) the Asset Value of the Partnership. The term "Asset Value" means, with respect to the Partnership, the value of one or all, where relevant, of the assets of the Partnership, as determined in accordance with the provisions of the Agreement, as of the date on which such determination is made.

[141] I disagree that section 1.9(kk) shows that a limited partner of BRC has an ownership interest in the assets of BRC. This section shows how the "Ownership Percentage" of a given limited partner is determined. The Ownership Percentage is used to determine the percentage ownership interest of a limited partner in the Partnership (BRC). This section does not provide that a limited partner of BRC has an ownership interest in the property of BRC.

[142] SDC relies on section 10 of the Bond under the heading Ownership that reads:

> This bond shall apply to loss of **Property** (1) owned by the Insured, (2) held by the Insured in any capacity, or (3) for which the Insured is legally liable. This bond shall be for the sole use and benefit of the Insured named in the Declarations.

[143] SDC submits that ownership as used in the Bond is broadly defined to include property held by the Insured in any capacity. SDC submits that this provision of the Bond captures a loss of SDC's share of the "Net Asset Value" of BRC.

[144] I disagree that SDC had any proprietary interest in the money it paid to BRC (by wire transfer) after the transfer was completed. Upon receipt, BRC became the owner of the transferred money. This is plainly shown by section 1.4 of the Limited Partnership Agreement which reads:

> All property owned by BRC shall be deemed to be owned by the Partnership and no partner, individually, shall have any interest in such property. Title to all such property shall be held in the name of the Partnership or, at the discretion of the General Partner, may be held in the name of the General Partner, or any entity approved by the General Partner, as nominee for the Partnership.

[145] SDC has failed to show that there was a Theft (an unlawful taking to the deprivation of SDC's investors) of Customer Property by Brenda Smith. Only BRC had a property interest in the money stolen or diverted by Ms. Smith.

[146] I conclude that SDC has failed to establish that it sustained a loss resulting directly from Theft of Customer Property by a Registered Representative that falls within the initial grant of coverage in Insuring Agreement (A)(4).

Does SDC have coverage for the loss claimed under Insuring Agreement (B)(1)(b)?

[147] SDC also claims coverage for its loss under Insuring Agreement (B)(1)(b) of the Bond which, under the heading "On Premises", reads:

> The Underwriter ... agrees to indemnify the Insured for:
>
> Loss of Property resulting directly from ...
>
> (b) theft, false pretenses, common law or statutory larceny committed by a natural person present in an office or on the premises

> of the Insured or on the premises where the Property is lodged or deposited,
>
> while the Property is lodged or deposited within offices or premises located anywhere.

[148] The word "Property" is defined in section 1(s) of the Conditions and Limitations part of the Bond:

> (s) Property means Money, Certificated Securities, Uncertificated Securities of any Federal Reserve Bank of the United States, Negotiable Instruments, Certificates of Deposit, documents of title, Acceptances, Evidences of Debt, security agreements, Withdrawal Orders, certificates of origin or title, Letters of Credit, insurance policies, abstracts of title, deeds and mortgages on real estate, revenue and other stamps, tokens, unsold state lottery tickets, books of account and other records whether recorded in writing or electronically, gems, jewelry, precious metals of any kind and in any form, and tangible items of personal property which are not hereinbefore enumerated.

[149] SDC submits that the evidence shows that Brenda Smith's false representations, which, it contends, constituted false pretenses, were made to Mr. Shlien (representing SDC) when he attended at BRC's offices on October 9, 2018. Prior to the A Funds investments in BRC, Mr. Shevland met with Ms. Smith at an office of the A Funds where she made false representations.

[150] SDC submits that it sustained a Loss of Property resulting from theft or false pretenses by Brenda Smith, a natural person, in an office. SDC submits, therefore, that it is covered for its loss and is entitled to indemnification under the Bond.

[151] I disagree that the language of Insuring Agreement (B)(1)(b) referring to theft or false pretences "in an office" should be interpreted to mean in any office in the world. It would not make sense for the words "in an office" to mean any office in the world when the following words "or on the premises of the Insured" are qualified to be limited to the premises "of the Insured". The words "in an office", read with the words that immediately follow, mean in an office of the Insured.

[152] SRC has not shown that it sustained a loss at the time it was induced to transfer money to BRC by Ms. Smith's false promises. No one sustained a loss of Property when Ms. Smith made false promises or at the moment the wire transfers of funds to BRC were completed. A loss of Property was only sustained when Ms. Smith diverted money as part of the fraudulent Ponzi scheme.

[153] SDC submits that the reference to "present" in this insuring agreement should be broadly interpreted to cover theft or fraud by way of electronic acts. SFC submits that such an interpretation accords with the reasonable expectations of the parties who would

reasonably expect that SDC and BRC would use modern-day electronic banking and communications technologies. SDC submits that it is not necessary for it to show that Brenda Smith was physically present at the financial institution where BRC had its account when the money was stolen.

[154] In *Southern National Bank of North Carolina v. United Pacific Insurance Company*, 864 F. 2d 329 (Court of Appeals, 4th Circuit 1989), the Court addressed the interpretation of a bond that provided coverage for loss of property under an insuring agreement with the same wording, in material respects, as Insuring Agreement B(1)(b) (although the word "of" followed "office", which added clarity). The Court denied coverage for the loss claimed because the wrongdoer was not physically at the offices of the insured when, based on the false pretenses of the wrongdoer, money was wired out of the insured's account, nor was he physically on the premises of the institution where the money was on deposit when it was taken. In reaching this conclusion, the Court held:

> To adopt SNB's interpretation of "false pretenses" would require the court to read the "on premises" requirement out of the blanket bond. Under SNB's theory, a person who used a telephone or computer link from anywhere in the world to make a misrepresentation to a bank and who later received money in hand as a result of the deceit would be deemed to have been on the same premises as the money when he or she used false pretenses. Such a theory would directly contravene the purpose of the "on premises" language. Commentators, including those in the banking industry, have emphasized that the "on premises" requirement in standard blanket bonds is designed to exclude coverage for losses from fraud perpetrated by telephone or computer, except in those rare instances where the perpetrator phones or uses a computer hookup from the property of the bank itself or from the property of a custodian entrusted by the bank to safeguard the funds.
>
> ...
>
> The "on premises" language is designed to limit coverage to losses sustained because of the fraudulent act of a person physically present at the bank or where the bank's money is deposited. It plainly so states. The actual physical location of the defrauder in relation to the place of deposit is the important fact. Legal fictions developed for other purposes simply have no relevance.

[155] The *Southern National* decision is an appellate decision from the U.S. Although it is not binding on me, I agree with the reasoning of the Court of Appeals for the Fourth Circuit in the passage I have cited. I was not provided with a Canadian authority on this point. I conclude that the plain meaning of Insuring Agreement (B)(1)(b) is that for there to be coverage for a loss under this Insuring Agreement, the wrongdoer must be physically present in an office of the Insured or on the premises of the Insured when the theft or false pretenses is committed or on the premises where the Property (money in this case) is lodged or deposited.

[156] There is no evidence of where Ms. Smith was located when she committed theft of money.

[157] For this reason, SDC has failed to establish that the loss claimed falls within the initial grant of coverage in Insuring Agreement (B)(1)(b) of the Bond.

[158] SDC's loss does not fall within the initial grant of coverage under this insuring agreement for another reason.

[159] SDC submits that SDC wired money to BRC's prime broker account and that SDC, as an investor, had a capital account with BRC in respect of which BRC would periodically issue statements to SDC which recorded the funds in its account. SDC submits that instead of investing SDC's funds, Ms. Smith stole the funds in SDC's account with BRC and used the money to perpetrate her Ponzi scheme.

[160] In making these submissions, SDC contends that the evidence shows that Ms. Smith stole SDC's money. To the contrary, the evidence shows that this did not happen. Upon the completion of wire transfers to BRC, BRC became the owner of the money that was transferred. As I have noted, this is plainly shown by section 1.4 of the BRC Limited Partnership Agreement. SDC had an interest in BRC as a limited partner. Ms. Smith did not steal or divert any of SDC's money. The loss of Property resulting from Ms. Smith's fraudulent acts was a loss sustained by BRC and not by SDC.

[161] For this reason as well, SDC has failed to show that its loss falls within the initial grant of coverage in Insuring Agreement (B)(1)(b) of the Bond.

If there is coverage for SDC's loss in the initial grant of coverage, does the exclusion in section 2 (x) apply?

[162] As a result of my conclusions with respect to whether SDC has met its onus of first establishing that the loss claimed falls within the initial grant of coverage in the Insuring Agreements in the Bond, it is not necessary for me to decide whether Berkshire has met its onus of establishing that one of the exclusions to coverage applies.

[163] If I have erred in concluding that SDC has not met its initial onus, I address the exclusion upon which Berkshire relies.

[164] Berkshire relies on the exclusion in section 2(x) under the heading "Exclusions" which reads:

> Section 2. This bond does not cover:
>
> (x) loss resulting directly or indirectly from any dishonest or fraudulent act or acts committed by any non-**Employee** who is a securities, commodities, money, mortgage, real estate, loan, insurance, property management, investment banking broker, agent or other representative of the same general character;

[165] The evidence shows that Brenda Smith, at all material times, was a securities broker and also the owner of a broker/dealer business, CV Brokerage.

[166] Berkshire submits that the loss claimed by SDC resulted directly from dishonest acts committed by Ms. Smith, a "non-Employee" who is a securities broker and, therefore, the loss is excluded from coverage under the Bond.

[167] In support of this submission, Berkshire relies on *Jacobson Family Investments, Inc. v. National Union Fire Insurance Company of Pittsburgh*, 129 A.D. 3d 556, a decision of the Appellate Division of the Supreme Court of New York. In *Jacobson*, the plaintiff filed a claim with the insurer under a bond for alleged losses it sustained as a result of the dishonest acts of Bernard L. Madoff who was arrested in 2008 for running a Ponzi scheme. He pleaded guilty to various charges involving securities fraud. The Appellate Division reversed the decision of the trial judge because it concluded that the evidence at trial showed that Madoff, in perpetrating his Ponzi scheme, was acting in a hybrid capacity as both an investment advisor and a securities broker. The Court held, alternatively, that the exclusion would otherwise exclude coverage because Madoff was not the plaintiff's "Employee" (as defined in the bond) and he was a registered broker-dealer during the entire period he dealt with the plaintiff.

[168] SDC submits that exclusion (x) is not applicable to Insuring Agreement (A)(4) which covers theft committed by a registered representative. SDC submits that to apply exclusion (x) as Berkshire submits would negate the coverage afforded by Rider 13 and render such coverage illusory. Under the interpretation advanced by SDC with respect to Rider 13, SDC contends that Ms. Smith was an "Employee" and, therefore, exclusion (x) does not apply.

[169] If I had accepted SDC's interpretation of the Bond on the basis that Ms. Smith is an "Employee" of BRC and the Bond should be interpreted such that addition of Rider 13 is effective to provide for a grant of coverage to SDC under the Bond for loss it sustained by dishonesty or fraud by Ms. Smith as an Employee BRC, a Subsidiary, I would not exclude coverage based on exclusion (x) because Ms. Smith, although she was a securities broker, would not have been a "non-Employee".

What is the effect of the warranty given by Mr. Shlien?

[170] When SDC sought an increase in the limits of coverage under the Bond effective February 26, 2019, Mr. Shlien signed a written warranty that no person or entity for whom this insurance is intended has any knowledge or information of any act, error, omission, fact or circumstance which may give rise to a claim which may fall within the scope of the proposed insurance. The warranty provides that if such information exists, any claim arising therefrom is excluded from the proposed coverage.

[171] Berkshire submits that the insurance under the Bond was intended for BRC because it was named as a Subsidiary, an insured entity under the Bond. Berkshire submits that Ms. Smith knew of her own fraud and, therefore, the warranty was untrue and coverage is excluded.

[172] SDC denies that the Bond was intended for BRC because, it contends, BRC was not an insured entity.

[173] At the time the warranty was given, Mr. Shlien's understanding was that he had obtained insurance coverage under the Bond for a loss sustained by the SureFire Entities, including SDC. His evidence is that he discussed with Mr. Morency that he was seeking insurance coverage for SureFire entities for loss resulting from fraud or theft by external advisors, like BRC. He was not seeking insurance coverage for a loss sustained by BRC. BRC is not a named Insured in the Bond. The warranty letter, prepared by Berkshire, does not refer to a "Subsidiary" as an insured entity.

[174] I find that Mr. Shlien did not intentionally make an untrue statement in the warranty.

[175] If I had concluded that SDC established that the loss claimed falls within the initial grant of coverage in one of the Insuring Agreements, this would be because I accepted SDC's submission that BRC is not an insured entity but was named as a Subsidiary to expand the scope of coverage to SDC under the Bond to cover loss resulting from fraud and theft by a sub-advisor, including through a Ponzi scheme by the directing mind of the sub-advisor.

[176] If I had so concluded, BRC would not be an insured entity for whom the insurance was intended. I would not have excluded coverage because the warranty is untrue as a result of Ms. Smith's own knowledge of the Ponzi scheme.

[177] Berkshire submits that the evidence shows that, when the warranty was given, Mr. Shevland was aware of facts which might have given rise to a claim which might fall within the scope of the insurance coverage under the Bond.

[178] Mr. Shevland testified about his knowledge of Ms. Smith's fraud. He testified that he was not suspicious until July 4, 2019 when he was with his family and opened an email and saw the list of assets of BRC that Ms. Smith provided in the arbitration proceeding that, he knew, was nonsense. He testified that he felt like he was kicked in the stomach a thousand times because, before this, he trusted Ms. Smith and considered her a close friend to him and his family.

[179] I accept Mr. Shevland's evidence in this respect.

[180] If I had concluded that SDC has coverage for a loss under the Bond, I would not exclude coverage for the loss because Mr. Shlien's warranty was untrue in respect of Mr. Shevland's knowledge.

Did SDC have a duty to disclose to Berkshire the in-kind transfer of the A Funds' interests in BRC to SDC?

[181] SDC did not disclose to Berkshire its acquisition of the interests of the A Funds in BRC. As a result of this acquisition, the capital account of SDC with BRC, on paper, increased by approximately $26 million USD (excluding the fake returns shown in statements). SDC makes a clam in this litigation for indemnification for a loss associated with this transaction.

[182] General Agreement B in the Bond reads:

> If the Insured shall, while this bond is in force, consolidate or merge with, or purchase or acquire assets or liabilities of, another institution, the Insured, not have such coverage as is afforded under this bond for loss which
>
> (a) has occurred or will occur in offices or premises, or
> (b) has been caused or will be because by an employee or employees of such institution, or
> (c) has arisen or will arise out of the assets or liabilities
>
> acquired by the Insured as result of such consolidation, merger or purchase or acquisition of assets or liabilities unless the Insured
>
> (i) gives the Underwriter written notice of the proposed consolidation, merger or purchase or acquisition of assets or liabilities prior to the proposed effective date of such action and
> (ii) obtains the written consent of the Underwriter to extend the coverage provided by this bond to such additional offices or premises, **Employees** and other exposures, and
> (iii) upon obtaining such consent, pays to the Underwriter an additional premium.

[183] Berkshire submits that SDC had an obligation to disclose its acquisition of the interests of the A Funds in BRC.

[184] In *Sagl v. Chubb Insurance Company of Canada*, 2009 ONCA 388, at para. 51, the Court of Appeal explains the duty of disclosure of an insured:

> The starting point in the analysis of this ground of appeal attracts no debate. The relationship between an insurer and an insured is contractual in nature. But contracts of insurance are no ordinary contracts; special rules apply. Chief among these is the doctrine of *uberrima fides* that holds the parties to a standard of utmost good faith in their dealings with each other. It places a heavy burden on applicants for insurance coverage to provide full disclosure to the insurance company of all information relevant to the nature and extent of the risk that the insurer is being asked to assume: *Coronation Insurance Co. v. Taku Air Transport Ltd.*, 1991 CanLII 16 (SCC), [1991] 3 S.C.R. 622, at p. 636. A fact is relevant or material if it would influence a prudent insurer in deciding whether to issue the policy or in determining the amount of the premium: *Mutual Life Insurance Co. v. Ontario Metal Products Co. Ltd.*,1924 CanLII 336 (UK JCPC), [1925] 1 D.L.R. 583 (P.C.), at p. 588; *Gauvremont v. Prudential Insurance Co. of America*, 1940 CanLII 65 (SCC), [1941] S.C.R. 139, at p. 160; *Fidelity & Casualty Co. of*

> *New York v. General Structures Inc.*, 1976 CanLII 213 (SCC), [1977] 2 S.C.R. 1098, at p. 1110. Whether a misrepresentation or non-disclosure is material is a matter of fact to be determined by the trier of fact: see s. 124(6) of the *Insurance Act*, and *Mutual Life* at p. 588. However, there is a subjective element to the test as well. The non-disclosure or misrepresentation must have induced the insurer to enter into the contract: see s. 124(4) of the *Insurance Act*; see also *Taylor v. London Assurance Corp.*, 1935 CanLII 2 (SCC), [1935] S.C.R. 422, at p. 429.

[185] In *Sagl*, the Court of Appeal, at para. 52, explains that the duty to disclose all material facts applies even in the absence of questions from the insurer, although the absence of questions may be evidence that the insurer does not consider a fact to be material. The consequence of non-disclosure is that the insurer is entitled to void the insurance contract *ab initio*.

[186] In *Silva v. Sizoo*, [1997] O.J. No. 4910, Lane J. explained, at para. 34, how materiality is determined:

> The test of materiality is objective, not subjective or particular to whatever insurer may be involved. If that were not so, it would be open to an insurer to assert, after the event, that it would not have accepted the risk based on its own private internal underwriting considerations however removed from the industry practice they might be. The insurer's underwriting rules must be shown to be in reasonable conformity with the ordinary standards for measuring insurable risks applied by insurers generally. Materiality, therefore, must be tested in the context of a "reasonable" insurer.

[187] In *1013799 Ontario Limited v. Kent Line International Ltd*., 2000 CarswellOnt 2865, Lamek J., at para. 35, approved the statement of MacFarland J. (as she then was) in *Nuvo Electronics Inc. v. London Assurance* (2000), 19 C.C.L.I. 195, at para. 73, that the insurer must show, first, that it did in fact regard the non-disclosure as material and, second, that a prudent, independent underwriter takes the same view.

[188] SDC relies on section D of the General Conditions of the Bond that reads:

> The Insured represents that the information furnished in the application for this bond is complete, true and correct. Such application constitutes part of this bond.
>
> Any intentional misrepresentation, omission, concealment or incorrect statement of a material fact, in the application or otherwise, shall be grounds for the rescission of this bond.

[189] SDC submits that Mr. Shlien did not make any intentional misrepresentation, omission, concealment or incorrect statement of a material fact. SDC submits that Berkshire has failed to provide evidence that information about the A Funds transaction would have been

material to Berkshire. SDC submits that Berkshire has failed to show that this information is material from on objective perspective.

[190] Mr. Knight was asked whether, had he known in February 2019, that the A Funds intended to transfer their investments in BRC to SDC, this information would have affected his underwriting decisions. He answered that this information could have potentially affected his underwriting. He stated that Berkshire would have had a lot of questions around the nature of the assignment and the reasons that an interest in a subsidiary under a policy was being transferred through a vehicle within the named Insured's organization. Mr. Knight testified that Berkshire would have had a number of questions that could have affected either the limit of coverage or its willingness to provide coverage moving forward.

[191] I regard Mr. Knight's answer to be an honest one that shows that Berkshire would have regarded the information to be material. Since the information was not provided, Mr. Knight could not say for sure whether or how Berkshire's underwriting decisions would have changed. This, as Mr. Knight fairly put it, would have depended on the answers to questions that Berkshire never asked because it was not told of the A Funds transaction.

[192] Mr. Knight's evidence, which I accept, is that Berkshire would have had a lot of questions about this transaction and the reasons for it. I do not regard the fact that Berkshire did not ask about this transaction in particular or, more generally, whether or where SDC intended to find new investors for its fund to be evidence that shows that Berkshire does not consider this information to be material.

[193] The transfer of the A Funds interest in BRC to SDC was unlike a new investment by an existing investor or a new investor of SDC who would be contributing new funds for investment in the ordinary course of the business of SDC. The A-Funds investment (with a value on the statements sent by BRC of far higher than the $26 million USD capital contribution made by the A Funds) had been made years before and the transfer to SDC was made, in part, so that the A Funds could access the Bond as coverage for theft and fraud by BRC. When Mr. Knight was first approached by Mr. Morency about coverage for external advisors, he was told that the situation was unique, and, in his evidence, he agreed.

[194] In these circumstances, from the objective perspective of an underwriter offering the same fidelity bond coverage as coverage provided by the Bond, the transaction with the A Funds would have been material information that the underwriter should have been given to assess its underwriting decisions involving coverage, limits of loss, and premiums to be charged. This information would be relevant to the nature and the extent of the risk that the insurer is asked to assume.

[195] Under General Agreement B of the Bond, SDC was required to disclose information regarding the A Funds transaction Berkshire and obtain its consent to extend coverage under the Bond to loss sustained by SDC, if covered by the Bond, from the transfer from the A Funds to SDC of their interests in BRC.

[196] If I had held that SDC is covered under the Bond a loss claimed, I would exclude coverage for the loss claimed to the extent that it arises from the transfer to SDC by the A Funds of their interests in BRC.

What is the amount of SDC's loss?

[197] SDC's Proof of Loss claims a loss of $46,598,676.84 USD.

[198] SDC's evidence is that it invested a total of $4,510,000 USD with BRC between December 26, 2018 and January 31, 2019. The A Funds invested $26,730,000 USD with BRC between September 8, 2016 and May 3, 2018. The total amount invested is $31,240,000 USD.

[199] As of April 30, 2019, SDC's total investment with BRC was $46,598,676.84 USD as shown on account statements.

[200] In its closing submissions, counsel for SDC accepted that SDC's loss does not include the amount shown on account statements reflecting fictional investment returns over and above the total amount paid to BRC by SDC and by the A Funds. SDC limits its claim to $31,240,000 USD.

[201] On February 27, 2019, the A Funds transferred the full balance of their interest in BRC to SDC through an "in-kind" transaction. The interest held by the A Funds in BRC at the time of the transfer was a limited partnership interest in BRC. As part of this transaction, the A Funds entered into a Subscription Agreement whereby they acquired limited partnership interests in SDC. Under the Subscription Agreement, the A Funds released SDC and its general partner from any and all claims arising out of any actions or inactions of the partners or managers of the "Underlying Funds" which included BRC.

[202] Although the amounts in account statements sent to the A Funds by BRC showed substantial balances in the A Funds capital accounts, it was later discovered that Brenda Smith had been perpetrating a Ponzi scheme that involved theft of money received by BRC from investors such as the A Funds. There is no evidence that on February 27, 2019, the interest of the A Funds in BRC that was transferred to SDC had any value.

[203] SDC contends that it sustained a loss from the loss of the A Funds' investments in BRC (that were transferred to SDC) because of the dishonest and fraudulent acts of Brenda Smith. In support of this submission, SDC cites *Oshawa Group Ltd. v. Great American Insurance Co*., 1982 CanLII 1855 (ON CA).

[204] In *Oshawa Group*, the insured made a claim for indemnification for loss resulting from receipt of secret commissions by an officer of one of the insured's subsidiaries. The action was dismissed on the ground that the insured had failed to establish any loss to support a claim for indemnity. On appeal, the Court of Appeal held that under "fidelity bond" insurance policies, an insured suffers a loss when it shows that it has been deprived of its property by a peril against which it was insured. The Court of Appeal held that as soon as the wrongdoer fraudulently and dishonestly received secret commission, the insured was

deprived of its money and suffered a loss measured by the amount of secret commission or bribe.

[205] SDC submits that it was deprived of the A Funds' investments because were it not for the fraudulent acts by Brenda Smith, SDC would have had the benefit of the value of the A Funds' investments and it could have continued to invest in BRC or redeemed its capital account and invested the redeemed amount elsewhere. SDC submits that its loss must be valued at the date of Brenda Smith's theft of the funds invested by the A Funds. SDC submits that the value of the A Funds' investment in BRC at the time that they transferred their interest in BRC to SDC is irrelevant.

[206] I disagree that SDC has shown that it sustained a loss from deprivation of the A Funds' investment in BRC.

[207] The A Funds transferred their interest in BRC (a limited partnership interest) to SDC on February 27, 2019, a few months before SDC requested redemption of its capital account from BRC. This request was not honoured because, as it turned out, Ms. Smith was running a Ponzi scheme through BRC. SDC did not pay anything to acquire the A Funds' interest in BRC, and it is not liable to the A Funds by reason of Ms. Smith's fraudulent Ponzi scheme. SDC has not shown that the A Funds' interest in BRC had any value at the time of SDC's acquisition of this interest, or at any time thereafter.

[208] Given that SDC never held any property of value from its acquisition of the A Funds' interest in BRC (it acquired a worthless limited partnership interest in BRC), it did not sustain a loss resulting from Brenda Smith's dishonest acts and theft, even though they were only discovered after SDC had acquired the A Funds' (apparently worthless) interests in BRC.

[209] If I had held that SDC is covered under the Bond for its loss under the Insuring Agreements in the Bond, I would have ordered that SDC's loss is limited to $4,510,000 USD.

SDC's claim for punitive damages for alleged bad faith conduct by Berkshire

[210] SDC claims that Berkshire engaged in conduct that is egregious, malicious, arbitrary, high-handed, and reprehensible, such that it warrants an award of punitive damages. SDC claims that an award of $5 million USD is appropriate in the circumstances.

[211] SDC submits that Berkshire failed to act promptly after receipt of SDC's Proof of Loss and failed to respond to SDC within 60 days after receiving it. SDC submits that Berkshire raised new allegations and defences related coverage on the eve of trial, and during the trial. SDC submits that Berkshire never asked SDC for information regarding its investors, the A Funds, and the transfer of the A Funds' interest in BRC to SDC. SDC submits that such failure to make inquiries, where Berkshire relies on SDC's non-disclosure of the A Funds transaction as material non-disclosure, is a breach of its duty of good faith owed to SDC and amounts to an unfair and deceptive practice.

[212] This is a complex insurance coverage case. There are many issues. The fact that Berkshire did not provide a full response to the claim of SDC within 60 days is not evidence of bad

faith. Nor is the fact that Berkshire made amendments to its pleading close to trial. I do dot agree that it was incumbent on Berkshire to ask questions about the A Funds or any investors in SDC, before raising as a defence SDC's failure to disclose the A Funds transaction.

[213] I find that SDC has tendered no evidence that Berkshire engaged in any conduct that was in bad faith or that justifies an award of punitive damages.

DISPOSITION

[214] For these reasons, SDC's action is dismissed.

[215] If the parties are unable to resolve costs, they may make written submissions in accordance with a timetable (and with page limits) agreed upon by counsel and approved by me.

Digitally signed by
Peter Cavanagh

CAVANAGH J.

Released: August 4, 2023

CITATION: SureFire v. Berkshire Hathaway, 2023 ONSC 4535
COURT FILE NO.: CV-20-00634017-0000
DATE: 2023-08-04

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:

SUREFIRE DIVIDEND CAPTURE, LP

– and –

NATIONAL LIABILITY & FIRE INSURANCE COMPANY c.o.b. as BERKSHIRE HATHAWAY SPECIALTY INSURANCE and ARTHUR J. GALLAGHER CANADA LIMITED

REASONS FOR JUDGMENT

CAVANAGH J.

Released: August 4, 2023