

CITATION: CLEAResult Canada Inc. v. Santomero, 2024 ONSC 6054
COURT FILE NO.: CV-24-00719420-00CL
DATE: 20241104

ONTARIO

SUPERIOR COURT OF JUSTICE (COMMERCIAL LIST)

BETWEEN:)
)
CLEAResult CANADA INC. and)
CLEAResult CONSULTING INC.)
Applicants (Defendants) *Sarah Whitmore and Kylie de Chastelain, for*
in CV-24-00718895-00CL) *CLEAResult Canada Inc. and CLEAResult*
) *Consulting Inc.*
– and –)
)
JASON SANTOMERO, KATHY) *Aaron Kreaden, for Jason Santomero,*
SANTOMERO and 11168843 CANADA) *Kathy Santoro, and 11168843 Canada Ltd.*
LTD.)
Respondents (Plaintiffs)
in CV-24-00718895-00CL))
)
)
)
) **HEARD:** October 15, 2024

2024 ONSC 6054 (CanLII)

KIMMEL J.

REASONS FOR DECISION

Background: Procedural Context

[1] The Applicants are seeking to enforce the agreed upon procedure in section 2.9 of the parties' Share Purchase Agreement dated June 27, 2022 (the "SPA" or the "Agreement"). That procedure would allow the appointed Independent Auditor, BDO Canada LLP ("BDO"), to proceed with the expert adjudication of the Reverse Earn-Out Calculation as prescribed under ss. 2.8 and 2.9 of the Agreement that was precipitated by the delivery of Reverse Earn-Out Calculations by the Purchaser (CLEAResult Canada Inc.) and Reverse Earn-Out Objection Notices delivered by the Vendors (Respondents).

[2] The Respondents argue that before the Independent Auditor can adjudicate the Reverse Earn-Out Calculation, there are other disputes under the SPA that first need to be adjudicated by the court (the "Other Disputes"). They have raised the Other Disputes in an action commenced on the regular civil list on November 1, 2023 under court file number CV-23-00708840-0000, now

CV-24-00718895-00CL (the "Action"). The expert who the Respondents have engaged says that the Independent Auditor does not presently have the information that would be needed to make a reliable determination of the Reverse Earn-Out Payments prescribed by the SPA.

[3] The Respondents say that when the parties jointly engaged the Independent Auditor it was agreed that the Independent Auditor would be jointly instructed to conduct a factual investigation that could be used in the adjudication of the Other Disputes. The BDO Engagement Letter dated August 28, 2023 was jointly signed by the parties on August 29, 2023. However, not long after it was signed, the parties reached an impasse over the scope of the BDO engagement.

[4] Having been jointly engaged by the parties, BDO refused to proceed without joint instructions from the parties. As noted earlier, the Action was commenced on November 1, 2023. This application was commenced on April 30, 2024 to advance BDO's expert adjudication of the Reverse Earn-Out Calculation and Payment. The parties disagree about which determination should proceed first, the Independent Auditor's determination of the Reverse Earn-Out Calculation and Payment or the determination of the Other Disputes by the court.

[5] I agree with the Applicants' position that the Reverse Earn-Out Calculation that BDO was engaged as the Independent Auditor to undertake should not be held up by the Other Disputes raised in the Action. BDO should be instructed to proceed with the mandate to determine the dispute about the Reverse Earn Out Calculation and determine the Reverse Earn-Out Payment in accordance with ss. 2.8 and 2.9 of the SPA and the relevant provisions of the BDO Engagement Letter.

[6] The adjudication of the Other Disputes (to the extent not rendered moot or already determined by the Independent Auditor) can proceed in the Action in the normal course. If the Respondents succeed in establishing breaches of the Earn-Out Covenants that are the subject of the Action and demonstrate that those breaches deprived them of a Reverse Earn-Out Payment that would have been payable, their contractual recourse is to claim indemnity from the Applicants for these losses. Their ability to do so in the Action is preserved.

[7] To the extent of any overlap, issues decided on this application that have also been raised in the Action should not be re-litigated. The Applicants have requested that the court order a stay of such overlapping relief sought in sub-paragraph 1(iii) of the Statement of Claim in the Action, in which the Vendor seeks: "An Order providing directions to the Parties regarding the information to be used to properly determine the Reverse Earn-out Payment amounts pursuant to sections 2.8 and 2.9 of the SPA."

[8] It is the Independent Auditor that must determine what information is needed for it to properly determine the Reverse Earn-Out Calculations and Payment amounts, if any. The Independent Auditor should proceed with its work now. That should render the relief sought in sub-paragraph 1(iii) of the Statement of Claim in the Action to be moot.

The Contractual Context: The SPA

[9] On June 27, 2022, the Respondents ("Vendors") sold their interests in Eco-Fitt Corporation (the "Corporation") to the Applicant, CLEAResult Canada Inc. ("CLEAResult" or the "Purchaser") pursuant to the SPA. The dispute underlying this application is about the determination of the Purchase Price payable under the SPA.

[10] One component of that Purchase Price is a Base Payment Amount in the adjusted amount of \$19,394,100 paid on the Closing Date (June 27, 2022). That is the guaranteed minimum amount that the Vendors have already been paid.

[11] The other component of the Purchase Price is a Reverse Earn-Out Amount, which was capped at \$42.4 million, ultimately to be calculated based on a formula to be applied at two points in time, each referred to as a Reverse Earn-Out Period.

[12] The Reverse Earn-Out component of the Purchase Price is dependent on how the Corporation performed post-closing. This was agreed to because of the challenge of valuing Eco-Fitt (and its future profitability) during the COVID-19 pandemic. Under the SPA, the Earn-out Amount is a multiple of EBITDA, a standard accounting metric that measures "earnings before interest, taxes, depreciation, and amortization", an accepted benchmark for a company's performance.

[13] The SPA had an overall Purchase Price Cap of \$63.4 million.

[14] Section 2.9 of the SPA prescribes an Earn-Out Procedure that spans over two periods, the First Earn-Out Period (January 1, 2022 and December 31, 2022) and the Second Earn-Out Period (May 1, 2022 until April 30, 2023). Ninety days after the end of each Earn-Out Period, the Purchaser was required to deliver a Reverse Earn-out Calculation Statement to the Vendor "setting forth in reasonable detail the Purchaser's calculation of EBITDA for the First Reverse Earn-Out Period or the Second Reverse Earn-out Period, as the case may be, and its determination of the resulting First Earn-out Payment or Second Earn-Out Payment, as the case may be (in each case, the "Reverse Earn-out Calculation")." The Reverse Earn-Out Amount is determined by a formula prescribed in s. 2.8 of the SPA.

[15] EBITDA is a defined term under the SPA that means the Corporation's earnings from operations before interest, income Taxes, depreciation and amortization, in each case, as adjusted, to exclude certain specified items, such as: "(viii): any expense that is related to events, costs or fees which are inconsistent with past practices of the Corporation or not taken in the normal day-to-day operations of the Corporation."

[16] Further, the parties agreed that EBITDA would be determined:

In accordance with GAAP, applied using the same accounting methods, practices, principles, policies and procedures, with consistent classification, judgment and valuation and estimation methodologies that were used in the preparation of the Financial Statements for the most recent financial year end except that (A) payroll expenses shall be recognized on an accrual basis, including reasonable accruals for

employees at each month-end; and (B) transactions denominated in US dollars shall be determined in accordance with GAAP.

[17] Under s. 2.9 (b) of the SPA, the Vendors had thirty days from their receipt of each Reverse Earn-Out Calculation Statement to review it. For the purposes of this review, the Purchaser was required to give the Vendors access to the working papers and accounting records and information used or created while preparing the applicable Reverse Earn-Out Calculation Statement. The Purchaser was also required to give the Vendors reasonable access to appropriate personnel so they could verify the accuracy and presentation of the Reverse Earn-Out Calculation Statement.

[18] Section 2.9 (b) of the SPA further provides that the Vendors can dispute any of the items in a Reverse Earn-Out Calculation Statement (namely "the Purchaser's calculation of EBITDA ... and its determination of the [Reverse Earn-out Payments]") by written notice to the Purchaser within the same 30 days ("Reverse Earn-out Objection Notice"). In that event, the parties agreed to attempt in good faith to resolve all the items in dispute. If all items in dispute were not resolved within thirty days, then either the Vendors or the Purchaser could submit the disputed items to be determined by the Independent Auditor. The parties agreed that the Independent Auditor would be BDO.

[19] Section 2.9 (c) of the SPA requires each Party to furnish to the Independent Auditor with all required working papers, schedules and other documents, accounting books and records and information relating to the items in dispute, that are available to that Party or its auditors (and in the case of the Purchaser, the Corporation's accountants if any). This section of the SPA further requires the Parties to instruct the Independent Auditor that time is of the essence in proceeding with its determination of any dispute. They further agreed that the decision of the Independent Auditor with respect to any item in dispute is to be in writing and that, absent any manifest error, the determination of the Independent Auditor would be final and binding on the Vendors and the Purchaser with no rights of challenge, review or appeal to the courts in any manner.

[20] The parties expressly agreed that the Independent Auditor, in making its determination of any dispute, is acting as an expert and not as an arbitrator and is not required to engage in a judicial inquiry worked out in a judicial manner.

[21] Section 2.11 of the SPA sets out the Reverse Earn-Out Covenants of the Purchaser. This section of the SPA allows the Purchaser to operate in the Ordinary Course after Closing, subject to certain specified provisos (the "Reverse Earn-Out Covenants"). It was agreed that:

- a. The Purchaser and the Corporation would not take any direct or indirect action for the purpose of reducing the amount of (or eliminating) the First Earn-out Payment and/or the Second Earn-out Payment and the payments owed pursuant to Section 2.8;
- b. Jason would continue to have day-to-day operational control of the Business subject to the terms of the Employment Agreement (recognising that the payment of any

Reverse Earn-Out Amount would not be contingent or conditional upon Jason's continued employment by the Corporation);

- c. The Purchaser would not, and would not cause the Corporation to, terminate any employees or consultants of the Corporation in a manner different from the Ordinary Course; and
- d. The Purchaser would ensure that the Corporation maintains, in a financial record keeping system, complete and accurate records with respect to matters required to determine EBITDA and would generate separate financial statements of the Corporation. Further to that, the Purchaser would cause the Corporation and any subsidiary of the Corporation to maintain financial statements, financial ledgers and other financial books and records for the Corporation in accordance with GAAP and past practice. Two exceptions would apply: (A) payroll expenses would be recognized on an accrual basis, including reasonable accruals for employees at each month-end; and (B) transactions denominated in US dollars would be determined in accordance with GAAP.

[22] The SPA provides that: "Ordinary Course" means, with respect to an action taken by a Person, that the action is consistent with the past practices of the Person and is taken in the normal day-to-day operations of the Person.

[23] The parties further agreed in s. 7.3 of the SPA that the Purchaser would indemnify the Vendors for "any breach or non-performance by the Purchaser of any covenant or other obligation contained in this Agreement or in any contract, agreement, instrument, certificate or other document delivered pursuant to this Agreement". CLEAResult Consulting Inc. is the parent and guarantor of the Purchaser's obligations under the SPA.

[24] Section 7.11 of the SPA provides that, unless otherwise provided in that Agreement, the provisions of Article 7 constitute the sole remedy available to any Vendor and the Purchaser to any Claim for breach of covenants, representation, warranty or other obligation or provision of this Agreement.

Other Factual Context: Subsequent Events

[25] The Purchaser and the Vendors delivered the following Reverse Earn-Out Statements and Objection Notices in accordance with s. 2.9 (a) of the SPA:

- a. On March 30, 2023, CLEAResult delivered a Reverse Earn-Out Statement which reported a First Earn-Out Payment of \$0, based on total EBITDA of approximately \$2,600,000.
- b. The Vendors disputed the calculation and exercised their rights set out in section 2.9(b) of the SPA to request information to verify the accuracy and presentation of

the Reverse Earn-Out Statement. Some information was provided but the Vendors did not consider it to be sufficient.

- c. On May 19, 2023, the Vendors issued a Reverse Earn-out Objection Notice (the "First Objection Notice") that raised issues with the information provided by CLEAResult, detailed a list of "concerns" with the First Reverse Earn-out Calculation Statement and separately listed "concerns" that "the Corporation has not been operated in accordance with certain of the covenants contained in section 2.11(a) of the SPA."
- d. Various discussions ensued, and the Vendors continued to request documents and raise concerns about the EBITDA calculation and about alleged breaches of the Earn-Out Covenants by the Purchaser that, if established, the Vendors maintained could impact the EBITDA calculations.
- e. On July 11, 2023, CLEAResult wrote to BDO to appoint it as the expert (Independent Auditor) to resolve the dispute over the Reverse Earn-Out Amount.
- f. On July 28, 2023, CLEAResult provided the Vendors with the Reverse Earn-Out Statement for the Second Earn-Out Period, in which CLEAResult determined that the Vendors were entitled to a Second Reverse Earn-Out Payment in the amount of \$2,491,500, based on a total EBITDA amount of \$3,126,500 (amounting to approximately 5% of the total \$42.4 million potentially available under the SPA).
- g. On August 25, 2023, the Vendors delivered their second Reverse Earn-Out Objection Notice, formally objecting to the Second Earn-Out Statement and raising similar objections to those raised in the First Objection Notice.
- h. On May 17, 2024, CLEAResult revised the position it took in the Second Reverse Earn-Out Statement and reduced the Earn-Out Payment to \$0.

[26] The Vendors engaged their own accountant to look at the Reverse Earn-Out Statements. Their accountants provided memoranda identifying various issues with the information that had been presented and indicating the additional information that it required to review the calculations.

[27] The parties discussed the possibility of expanding BDO's mandate as the Independent Auditor to include an investigative component. In addition to undertaking the accounting exercise contemplated by ss. 2.8 and 2.9 of the SPA, at the suggestion of the Vendors the parties explored also asking BDO to report on the factual issues and concerns that the Vendors had raised regarding how the business was operated pre- and post-closing that were the predicates to the alleged breaches of the Earn-Out Covenants alleged by the Vendors. The parties recognized that BDO would not be in a position to make legal findings about the alleged breaches of the Earn-Out covenants.

[28] Because the parties were already in the process of refining the terms of BDO's mandate when the Second Objection Notice was received by CLEAResult on August 25, 2023, the parties agreed to forego the 30-day resolution process prescribed at Section 2.9(b) of the SPA, and referred both Reverse Earn-Out disputes to BDO at the same time.

[29] BDO, the Purchaser and the Vendors jointly signed the BDO Engagement Letter on August 29, 2023, which included the following provisions:

- a. Section 8 of the Background section: "The Vendors and Purchaser seek our services as the "Independent Auditor", as defined within the Agreement, to determine all identified items in dispute in respect of the 2022 Calculation Statement and other matters that the parties may agree upon from time to time to refer to us for investigation.
- b. Section 9 of the Background section: "The Independent Auditor is to be jointly retained, and our costs paid equally, by the Vendors and the Purchaser."
- c. Section 1 of the Assignment section: "Assisting the parties in the identification of issues in dispute and assessment of whether a matter is to be referred to BDO for investigation (factual issues) or determination (financial issues)."
- d. Section 2 of the Assignment section: "A review of the written submissions provided by the Purchaser and Vendors pertaining to the agreed-upon issues that are referred to BDO. Our review will encompass copies of the relevant business records, calculation working papers, schedules, documents, accounting books, records and information pertaining to the contested matters."
- e. Section 4 (a) of the Assignment section: "investigative findings may be used to define issues in dispute or to facilitate the subsequent determination of legal issues or pursuit of remedies in an appropriate forum."
- f. Section 4 (b) of the Assignment Section: "Determination of the financial matters in dispute with respect to the Calculation Statement. It is our understanding that our determination of financial matters in dispute will serve as the final and binding decision for all parties involved."
- g. The Proposed Processes Section:
 - i. "All communications with BDO will be conducted jointly with the Vendors and Purchaser, unless explicitly waived by the party wishing to be excused.
 - ii. The Purchaser and Vendors will engage in discussions to identify the issues in dispute and the matters to be referred to BDO for its investigation or determination.

- iii. Based upon the issues referred to BDO for its investigation or determination, we will prepare a preliminary request list for information believed to be necessary to carry out mandate.
- iv. Each party will make its submissions, in writing, including any materials that the party wishes to be considered by BDO in our analysis.
- v. Each party's submission will be made available to the opposite party, who will be invited to provide its written response thereto.
- vi. Upon review of the parties' submissions, BDO may request additional documents or explanations, with responses to be provided in writing.
- vii. Each party will be given the opportunity to provide written comments further to submissions provided in response to BDO's requests.
- viii. BDO will circulate a draft of its investigative and/or Independent Auditor's Report on a "no numbers" and "no conclusions" basis with the parties to confirm the factual accuracy thereof.
- ix. Comments on our draft reports are to be submitted in writing to BDO (with copy to the opposite party).
- x. We will then issue our final, written reports setting out our investigation and/or our determination of items in dispute."

[30] On September 15, 2023, the Vendors proposed the "investigative issues" they wanted to be submitted to BDO and the financial questions relating to the calculations. The Purchaser objected to the proposed investigative issues and the scope of the proposed financial questions on the basis that they went too far. The parties' positions became polarized quickly and no agreement was reached on the investigative issues.

[31] By October 10, 2023 the Purchaser was insisting on a mandate for BDO that would be confined to "arriv[ing] at a numerical amount for both the First Reverse Earn-Out Payment and the Second Reverse Earn-Out Payment."

[32] The Vendors would not agree that BDO could or should attempt to calculate EBITDA for the First and Second Earn-out Payments prior to addressing their concerns relating to the information, practices and reporting on which that EBITDA was based. They had understood from the discussions leading up to the signing of the Engagement Letter that investigating the factual predicates of these concerns would be part of the expanded mandate of BDO.

[33] The Vendors commenced the Action on November 1, 2023, alleging among other things, that:

- a. CLEAResult failed to disclose the required level of information and documentation under the SPA (para. 46);
- b. CLEAResult failed to operate ECO-Fitt in the ordinary course and took steps to reduce the amounts payable under the Reverse Earn-Out Payments (para. 44)
- c. CLEAResult's breaches of the Reverse Earn-Out Covenants improperly reduced EBITDA and frustrated the Respondents' entitlement to a Reverse Earn-Out Payment, including breaches of:
 - i. section 2.11(a)(ii), which states that CLEAResult would retain Jason as Senior Vice President, Client Delivery Canada and authorize him to continue to have "day-to-day operational control" of the Eco-Fitt business, subject to the terms of his employment agreement.
 - ii. section 2.11(a)(iii), which states that the CLEAResult would not terminate, or cause Eco-Fitt to terminate, any employees or consultants "in a manner different from" the Ordinary Course.
 - iii. Section 2.11(a)(vi), which states that Eco-Fitt would not incur any capital expenditures outside of the Ordinary Course, in accordance with past practice.

[34] After receiving conflicting instructions, on December 12, 2023, BDO advised that based on the terms of the Engagement Letter that requires that "instructions be provided unanimously by the Vendors and Purchaser" it could not proceed without joint instructions. The Purchaser proposes to overcome that impasse by the declarations and orders that it seeks on this application.

This Application

[35] The Applicants indicated in their factum on this motion that they wanted the court to make an order directing BDO to immediately undertake the expert evaluation process described in s. 2.9 of the SPA.

[36] At the hearing, the court advised the Applicants that an order would not be made directing or requiring BDO to do anything since BDO was not on notice of this application and was not before the court. That led to a proposed revised form of order that, in accordance with the court's direction at the hearing, was provided in draft on October 22, 2024. That draft seeks an order directing the parties to jointly instruct BDO to carry out specific aspects of its mandate described in the BDO Engagement Letter directed to the expert evaluation process described in s. 2.9 of the SPA.

[37] The relief outlined in the revised draft order is in line with the relief sought in the Notice of Application.

The Issues

[38] The disputes raised by this application and the Action engage different parts of the SPA with different dispute resolution mechanisms. Specifically:

- a. Sections 2.8 and 2.9 (b) and (c) of the SPA describe the process by which CLEAResult calculates EBITDA and the Reverse Earn-Out Calculations, how the Respondents may challenge this, and if the dispute is not resolved, it is referred to BDO "acting as an expert and not as an arbitrator" to resolve the dispute in a manner that is "final and binding."
- b. Section 2.11 of the SPA specifies the obligations on CLEAResult after closing and during the Earn-Out Periods (described generally under the heading "Earn-Out Covenants"), including the conduct of business and maintenance of financial records in accordance with GAAP and in a manner consistent with past practice. The parties agree that their dispute in respect of the alleged breaches of these Covenants by the Purchaser and the Vendors' corresponding claims for indemnity under Article 7 of the SPA are legal matters for which the parties have irrevocably and unconditionally attorned to the jurisdiction of the Ontario Courts under 8.12 of the SPA.

[39] I have distilled from the written and oral submissions of the parties the following issues for the court's determination:

- a. As a matter of interpretation of the SPA as a whole and within its contractual context, what is the appropriate priority, timing and sequencing for the resolution of the existing disputes: (i) the Reverse Earn-Out Objection Notices under s. 2.9 of the SPA and (ii) the Other Disputes under Articles 7 and 8 of the SPA?
- b. Did the BDO Engagement Letter signed by both the Purchaser and the Vendors amend or vary what the SPA otherwise mandates with respect to the priority, timing and sequencing of the determination of these disputes?
- c. If the Reverse Earn-Out disputes must be referred to an Independent Auditor, should the relief sought at paragraph 1(iii) of the Respondents' Statement of Claim in the Action, seeking directions as to the information to be used in determining the Reverse Earn-out Payments, be stayed?

Analysis

[40] The parties agree that the basic principles of contract interpretation to be applied in this case are as follows:

- a. To give effect to the intentions of the parties by reading the SPA as a whole and giving the words of the SPA their ordinary and grammatical meaning: see *Ontario*

First Nations (2008) Limited Partnership v. Ontario Lottery and Gaming Corporation, 2021 ONCA 592, at para. 46, citing *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 SCC 53, [2014] 2 S.C.R. 633, at para. 47.

- b. To consider the surrounding circumstances, purpose of the agreement, objective evidence of background facts at the time of execution, and knowledge that was or "reasonably ought to have been within" the general knowledge of both parties: see *Corner Brook (City) v. Bailey*, 2021 SCC 29, [2021] 2 SCR 540, at para. 20, citing *Sattva* at paras. 48, 57-58.

The Priority, Timing and Sequencing of the Dispute Resolution Procedures

[41] Two distinct dispute resolution procedures have been engaged under the SPA:

- a. the dispute resolution procedure in s. 2.9 of the SPA (that mandates a timely determination by the Independent Auditor of the dispute raised by the Reverse Earn-Out Objection Notices about the Earn-Out Statement calculations of EBITDA and the determination of the Earn-Out Payments); and
- b. the dispute resolution procedure for a judicial determination under s. 8.12 of a claim for indemnity under Article 7 in respect of alleged breaches of Reverse Earn-Out Covenants under s. 2.11 of the SPA.

[42] It is a matter of interpretation of the SPA to determine the priority, timing and sequencing of the resolution of those disputes.

The First Dispute under Section 2.9: Independent Auditor's Review of EBITDA and Earn-Out Statement Calculations and Determination of the Earn-Out Payment

[43] The Vendors acknowledge that the dispute resolution procedure under s. 2.9 of the SPA has been engaged by the delivery of the Reverse Earn-Out Objection Notices.

[44] Inconsistently, the Vendors also argue that unless or until CLEAResult complies with its obligation to furnish the Respondents with the information they have requested, it cannot satisfy the conditions precedent to move forward with BDO's determinations to be made under s. 2.9 of the SPA. I do not find this argument persuasive. The requirement to furnish requested access to documents and personnel to the Vendors under the SPA arises within the period prior to the delivery of the Reverse Earn-Out Objection Notices. The Purchaser says it complied with its obligations under the SPA in response to the Vendors' requests. Although Vendors dispute this, they were able to prepare their Objection Notices.

[45] If the Vendors assert that they have not received adequate information from CLEAResult to assess the Reverse Earn-out Calculation Statements, their recourse under the SPA is to deliver a Reverse Earn-out Objection Notice and pursue the dispute resolution mechanism through BDO. This is exactly the recourse they pursued. The Objection Notices include as one of their complaints

that the Vendors received inadequate information and records. The matter is in BDO's hands. As discussed in more detail below, ultimately BDO can decide what records and information it requires, and BDO will receive (in fact has already received) input from the Vendors about this.

[46] The Vendors also acknowledge that the appointment of BDO represents a conscious choice by the parties to ensure that disputes over the EBITDA calculations will be resolved reliably by a decision-maker with the appropriate specialized expertise. The definition of EBITDA itself in the SPA contains over fifteen sub-bullets that variously require familiarity with GAAP and the application of other concepts that can be reliably addressed by an expert like BDO.

[47] The disputes that the parties agreed to have the Independent Auditor determine are issues of accounting relating to a significant element of the Purchase Price, the Reverse Earn-out Amount, which itself turns almost exclusively on an accounting metric, and the calculation of EBITDA of the Company. The amount in issue (\$43 million) is significant for both the Vendors and the Purchaser.

[48] The SPA expressly provides an alternative dispute resolution mechanism for this type of dispute (exempted from judicial determination by the court under s. 8.12), that is to be resolved quickly (time is of the essence) by a single jointly appointed expert with the expertise to decide the issue. This dispute resolution procedure is unquestionably intended to be faster and more streamlined than going to court.

[49] The Independent Auditor can receive documents and information from the parties and can request any other books of accounts, records, documents or information that the expert determines are needed to review. They can adjust (if necessary) the Purchaser's EBITDA. After receiving submissions from the parties, the Independent Auditor is tasked with the responsibility of determining the Reverse Earn-Out Payment using the formula that is dependent upon the EBITDA calculations.

[50] The SPA specifies that EBITDA is to be adjusted to exclude certain defined expenses and to comply with GAAP and the "accounting methods, practices, principles and procedures, with consistent classifications, judgments and valuation and estimation methodologies that were used in the preparation of the Financial Statements for the most recent financial year ... ". BDO has the expertise to assess and determine whether the expenses challenged by the Respondents (or any other expenses) were incurred in a manner that was inconsistent with past practices or not taken in the normal day-to-day operations of the Corporation and, if so, can exclude those expenses from its calculation of EBITDA.

[51] Consistent with the SPA, the parties provided in the BDO Engagement Letter that BDO would determine what records and information it requires to discharge its mandate. The Engagement Letter provides that BDO will first advise the parties what information it requires, after which either party can request that BDO consider additional materials.

[52] Agreeing that BDO, an expert accounting firm, would determine what it needs to make any required accounting adjustments to the "company's books and records" is consistent with the parties' intention to establish a timely, efficient, and binding expert accounting procedure for resolving disputes relating to EBITDA and the Reverse Earn-out Payments. By contrast, the Respondents' position that the court should provide "directions to the Parties regarding the information to be used to properly determine the Reverse Earn-out Payment amounts pursuant to sections 2.8 and 2.9 of the SPA" (as they request in paragraph 1(iii) of their Statement of Claim in the Action) would necessarily require the parties to retain expert accountants to inform the court's decision-making. As such, it would be inefficient and inconsistent with the agreed expert procedure.

[53] The express choice in the SPA of an expert adjudication process under s. 2.9 that would not involve "a judicial inquiry worked out in a judicial manner" is a strong indication that the court should not become involved in the mandated work of the Independent Auditor.

[54] Courts have recognized that commercial agreements to refer certain disputes to independent experts are a deliberate indication of the parties' intentions to swiftly and efficiently resolve such disputes outside the context of civil proceedings, which can be slow and expensive and create commercial uncertainty: see, for example, *KMH Cardiology Centres Inc. v. Lambardar Inc.*, 2022 ONSC 7139, at paras. 48-49; *Ivaco Inc. v. III Canada Acquisition Co.*, 2005 CanLII 29656 (ON SC), at para. 10.

[55] These cases relied upon by the Applicants, like the cases relied upon by the Respondents, are cases that were more focused on the question of the court's jurisdiction in the face of a contractually mandated expert dispute resolution procedure. The general comments about why parties would agree to such a process (as they did in this case) are still applicable.

[56] The Respondents' evidence in response to this application includes independent expert evidence from Mr. Cohen of Cohen Hamilton Steger & Co. Inc. (the "Cohen Affidavit"). Mr. Cohen reviewed the Other Disputes that are raised by the Vendors in the Action, noting that they "have the effect of decreasing EBITDA, either through higher expenses or lower revenues." Mr. Cohen (whose questions and challenges are reflected in earlier memoranda that accompanied the Respondents' Reverse Earn-Out Objection Notices previously delivered to BDO) expresses the view that if any of the alleged breaches of Earn-Out Covenants are found to have occurred, then "the Reverse Earn-out Calculations using the company's current/unadjusted books and records would not result in determination of the correct Reverse Earn-out Calculations."

[57] Mr. Cohen acknowledged, however, that his opinion assumes that BDO would not ask for information or make any adjustments to the Company's books and records as currently presented but would simply accept them at face value, without regard to the concerns or challenges raised in the Respondents' Reverse Earn-Out Objection Notices. This is not a reasonable assumption as it effectively assumes that BDO would not fulfill its mandate as the Independent Auditor. Mr. Mak of BDO, like Mr. Cohen, is an experienced forensic accountant and there is no reason for this court to assume that Mr. Mak is not capable of identifying the records and information that he needs to

carry out the work of the Independent Auditor in respect of the dispute over the Reverse Earn-Out Calculations and Payments.

[58] If BDO determines an expense was incurred in a manner inconsistent with past practices, or not taken in the course of normal day-to-day operations, then it is open to BDO to exclude it from EBITDA as part of its determination of the Reverse Earn-Out Payments. BDO is not presumptively required to accept the Purchaser's calculations.

The Second Dispute Under Sections 2.1 and 8.11 and Article 7: Alleged Breaches of Earn-Out Covenants to be Adjudicated in the Action

[59] The alleged breaches of the Earn-Out Covenants unquestionably must be adjudicated by the court in the normal course of the Action. In adjudicating the Other Disputes, the court will eventually have to determine whether:

- a. CLEAResult failed to operate ECO-Fitt in the ordinary course and took steps to reduce the amounts payable under the Reverse Earn-Out Payments; and
- b. CLEAResult took steps to improperly reduce EBITDA to frustrate the Respondents' entitlement to a Reverse Earn-Out Payment.

[60] For example, if it is determined that CLEAResult breached its obligations to operate the business in the manner required and did so for the purpose of reducing EBITDA to reduce or eliminate the Earn-Out Payments, that will not frustrate the exercise that is to be carried out by BDO as the Respondents suggest. BDO does not depend on the court's determination of whether an expense was incurred for the purpose of reducing EBITDA. BDO is only concerned with evaluating the expense in accordance with the specific criteria prescribed under the SPA, GAAP and past practices.

[61] The allegations in the Action, if proven, could lead to a claim for damages (and indemnity claims under the SPA).

Priority, Timing and Sequencing of Dispute Resolution Procedures

[62] The SPA does not expressly prescribe the priority, timing and sequencing of the determination of a dispute about the Reverse Earn-Out Calculation Statements in accordance with the prescribed process under s. 2.9 of the SPA and the determination of a dispute about whether CLEAResult has failed to comply with the Reverse Earn-Out Covenants in section 2.11 of the SPA in accordance with Articles 7 and 8 of the SPA.

[63] What the SPA does expressly specify is that the resolution of disputes within the purview of the expertise of the Independent Auditor should be expedited and should not involve the complications and delays of a judicial process, with discovery, competing experts etc. In the context of a share purchase agreement with a purchase price based, in part, on a multiple of EBITDA and a Reverse Earn-out Amount, the parties' deliberate decision to refer any accounting

disputes relating to those calculations to an accountant with specialized expertise, without court intervention, is commercially sensible.

[64] Requiring the expert focused dispute resolution process to await the outcome of another dispute that has engaged a judicial process that will, if it proceeds first, also result in competing experts addressing questions that overlap with the very questions to be decided by the Independent Auditor, will undermine the intended expedition, efficiency and simplicity of the prescribed process under s. 2.9 of the SPA. It is not commercially reasonable to interpret these provisions of the SPA in a manner that would allow a party to interrupt and delay that process by commencing civil proceedings thereby preventing the expert determination process from proceeding efficiently and promptly as the parties intended.

[65] If a breach of a Reverse Earn-out Covenant is proven the Respondents have the right to seek indemnification for any losses suffered "as a result of or arising in connection" with a "breach or non-performance" of "any covenant or other obligation" contained in the Agreement. For example, this could arise if it is later determined that a breach of an Earn-Out Covenant deprived them of an Earn-Out Payment that they would have otherwise been entitled to.

[66] To get around the clear contractual distinction between these two dispute resolution mechanisms and the express agreement that dispute resolution by the Independent Auditor proceed quickly and not be encumbered by the court's process, one of the arguments advanced by the Vendors is that the Purchaser's breaches of its Reverse Earn-Out Covenants have frustrated their right to a fair arbitration of the dispute to be determined by BDO by making it impossible to reliably determine EBITDA. The Vendors say these amount to repudiatory breaches of the agreement to refer that dispute to be decided by the Independent Accountant under s. 2.9 of the SPA, relying on *Bremer Vulkan v. South India Shipping*, [1981] A.C. 909, at p. 998.

[67] However, for the court to restrain an arbitration proceeding in circumstances where the foundation of the arbitration agreement is under attack, there must be some *prima facie* evidence that impeaches the arbitration mechanism: see *Deluce Holdings Inc. v. Air Canada* (1992), 12 O.R. (3d) 131 (S.C.), at p. 151. The Respondents cannot meet this high threshold because their argument, that BDO cannot fulfill the s. 2.9 SPA mandate is based on the false premise (assumed by Mr. Cohen, as discussed earlier in this endorsement) that BDO cannot ask for the information and records it needs to determine EBITDA in accordance with the SPA criteria, GAAP and past practices, and make whatever adjustments to the Purchaser's EBITDA calculations as BDO determines to be appropriate. Counsel for the Applicants confirmed during oral argument that BDO is entitled under SPA and the BDO Engagement Letter to any information and records it asks for regarding determination of EBITDA and Earn-Out Payment.

[68] The Respondents' assertion that allowing the expert adjudication to proceed will be prejudicial to them because it will lead to a final and binding determination that is based on information and records that are inaccurate is predicated on the same false assumption that BDO will not perform its mandate under s. 2.9 of the SPA.

[69] The Respondents do not like that the s. 2.9 (c) of SPA provides that BDO's work is to be, absent any manifest error, "final and binding ... with no rights of challenge, review or appeal to the courts in any manner." However, that is what the parties agreed to. It means that the court will have the benefit of the final calculations of EBITDA and the Reverse Earn-out Payments by BDO when it comes time to adjudicate the Respondents' claims for indemnification for breaches of the Earn-Out Covenants.

[70] As a practical matter, allowing BDO to proceed with its s. 2.9 SPA mandate ahead of the judicial process only has upside for the Respondents. The Reverse Earn-Out Calculation can never result in a negative payment (amount owing back to the Purchaser). CLEAResult's calculations are that \$0 is owing based on its EBITDA calculations.

[71] As a matter of contract interpretation, if parties agreed that any dispute about EBITDA calculations (that will in turn determine the dispute over the Reverse Earn-Out Calculation Statements and Payments) would be decided by one jointly appointed expert rather than a battle of experts in a prolonged court proceeding, that should be respected: see *Clearspring Capital Partners II c. Logistik Unicorn Holdings Inc.*, 2023 QCCS 894, at para. 65.

[72] BDO's determination will be a relevant data point for the court's adjudication of the Other Disputes. For example, once the parties and the court know what the Earn-Out Payment is and how it was calculated, they will be better positioned to determine if steps were taken by the Purchaser to suppress or eliminate it. The court's focus when adjudicating the claims for breaches of the Earn-Out Covenants will be on the intention of the Purchaser. That intention would not necessarily change the EBITDA calculation from an accounting perspective. In such a scenario, the Court would not be asked to re-calculate EBITDA (because whatever BDO determined regarding EBITDA and the dispute about the Reverse Earn-Out Statement Calculation cannot be relitigated in the action), but would still be able to assess the extent to which the Reverse Earn-Out, as calculated by BDO, was reduced or eliminated as a result of any established breaches of the Purchaser's Earn-Out Covenants.

[73] As a matter of interpretation of the SPA as a whole and within its contractual context, the appropriate priority, timing and sequencing for the resolution of the existing disputes, is for them to proceed in tandem but not necessarily on the same timelines. BDO shall be instructed by the parties to expeditiously proceed to determine the dispute raised by the Reverse Earn-Out Objection Notices under ss. 2.9 of the SPA and determine the Reverse Earn-Out Calculation and Payment in accordance with s. 2.8 of the SPA without regard to the Other Disputes under Articles 7 and 8 of the SPA that will be adjudicated in the Action in due course.

[74] The instructions to BDO can be limited to fulfilling those aspects of the BDO Engagement Letter (extracted from the Background, Assignment and Processes Sections set out in paragraph 29 of this endorsement) that are directed to the determination of financial matters (and not the investigation of factual matters).

BDO Engagement Letter: Implications for Priority, Timing and Sequencing of SPA Dispute Resolution Procedures

[75] Although it was discussed at length and provision was made for the possibility to expand the BDO mandate beyond the s. 2.8 and 2.9 SPA determinations, on a plain reading of the BDO Engagement Letter, the parties did not agree to an "investigative mandate" for BDO. The Engagement Letter reflects the parties' agreement that BDO would (1) carry out the mandate prescribed to it at section 2.9(c) of the SPA to "determine all identified items in dispute in respect of the 2022 Calculation Statement [Reverse Earn-Out Calculation Statements]"; and (2) determine any other "matters that the parties may agree upon from time to time to refer to us for investigation." The BDO Engagement Letter provided that the parties would need to agree to any investigative mandate for BDO through "discussions to identify the issues." However, no such agreement was reached.

[76] The Respondents tendered evidence about their intentions and understanding from the discussions and correspondence that preceded the signing of the BDO Engagement Letter. The Applicants objected to this evidence on various grounds.

[77] Even if the notes, drafts and negotiations are admissible (something that the court questioned during the hearing, and the Respondents had no authority on the point), they are not sufficiently persuasive to override the express wording of the BDO Engagement Letter. It required that the parties agree upon any other matters that would be referred to BDO for investigation, as distinct from the financial matters that were clearly delineated in the SPA to be referred to BDO to be determined as the Independent Auditor. The BDO Engagement Letter does not specify anything about the priority, timing and sequencing of the determination of the disputes.

[78] The BDO Engagement Letter did not amend or vary what the SPA otherwise mandates with respect to the priority and timing of the determination of the s. 2.9 SPA dispute over the Reverse Earn-Out Calculation Statement and 2.8 Payment Amount.

Partial Stay of the Action

[79] The Respondents have asked in their Statement of Claim in the Action for a declaration and order from the court about what information BDO should use to make its determination under s. 2.9 of the SPA. That is a matter for BDO to decide, not the parties or the court (as detailed earlier in this endorsement). The Applicants seek a stay of that aspect of the relief claimed in paragraph 1 (iii) of the Statement of Claim.

[80] The Respondents argue that an order cannot be made in this Application to stay relief sought in another proceeding, without a motion having been brought in that other proceeding. No authority was provided that is directly on point, but there is some logic to the Respondents' position.

[81] That said, the claim for relief in paragraph 1(iii) of the Statement of Claim is now moot in light of the finding made in this action between the same parties that they agreed that BDO would

determine the information it requires for the expert accounting determinations in section 2.9 of the SPA. The Statement of Defence pleads that the relief requested at paragraph 1(iii) of the statement of claim is within the exclusive jurisdiction of the Independent Auditor, and that very question has now been decided on this application.

[82] A stay may not be required in light of the findings in this decision, but if the Applicants still want a stay they will have to bring a motion for that in the Action. This decision (made in a proceeding involving the same parties and addressing the same issue) would likely render those claims in the Action to be *res judicata* in any event.

Final Disposition and Costs

[83] For the foregoing reasons, the Application is granted. I have signed a revised form of Order based on the submissions regarding the wording of this Order that were provided by the parties to the court after the hearing. The Order requires the parties to jointly instruct Mr. Alan Mak of BDO to undertake the expert evaluation process agreed to at section 2.9(c) of the SPA as follows:

- a. Except as clarified herein, BDO shall proceed in accordance with the terms of the BDO Engagement Letter, including the “proposed process” that is outlined on pages 3-4 of the BDO Engagement Letter;
- b. BDO’s mandate is restricted to (1) calculating EBITDA (as defined at section 1.1(hh) of the SPA) for the First Earn-Out Period and the Second Earn-Out Period and (2) determining a numerical amount for both the First Earn-Out Payment and the Second Earn-Out Payment on the basis of its EBITDA calculations; and
- c. BDO’s mandate does not include investigating or reporting on any factual or mixed fact and law issues underlying the Respondents’ allegations of breach of covenants that are alleged in the Respondents’ Statement of Claim in Court File No. CV-24-00718895-00CL (formerly Court File No. CV-23-00708840-0000).

[84] The parties advised during oral submissions that they have agreed that if one party is wholly successful, they shall be paid the all-inclusive amount of \$60,000 of costs for this application.

[85] The Applicants were successful, although not all of the relief in their Notice of Application has been granted, and not all of the specific relief sought in their factum and original draft order (for an order directing BDO to take specific steps and actions) was granted.

[86] The Respondents raised concerns about the lack of clarity around the Applicants' position regarding the scope of what BDO can look at in carrying out its mandate, particularly with respect to the ability of BDO to look at past practices, which the Applicants have now confirmed BDO can do as part of the determination of EBITDA. The Respondents raised further concerns about the Applicants' agreement in the BDO Engagement Letter to explore a broader investigative mandate for BDO that was almost immediately shut down without any real attempt to negotiate that broader mandate.

[87] If the Respondents are seeking to reduce the agreed upon quantum of costs to be awarded to the Applicants on this application, for any of the above, or other, reasons, the Respondents may deliver a brief cost submission of up to 3 pages double spaced within two weeks of the release of these reasons with a proposed reduced costs amount. The parties shall thereafter try to reach an agreement on costs, failing which, the Applicants may deliver a responding cost submission of up to 3 pages double spaced within two weeks of receiving the Respondents' submission. The Respondents' may deliver a reply cost submission of up to 1.5 pages double spaced within a week of receiving the responding submission.

[88] Once all cost submissions have been exchanged, they shall be uploaded into the hearing bundle in Case Center, and they shall also be sent by email to my judicial assistant: linda.bunoza@ontario.ca

[89] If an agreement is reached on costs, the parties shall notify me by email to my judicial assistant.

KIMMEL J.

Released: November 4, 2024

CITATION: CLEAResult Canada Inc. v. Santomero, 2024 ONSC 6054
COURT FILE NO.: CV-24-00719420-00CL
DATE: 20241104

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

BETWEEN:

CLEAResult CANADA INC. and CLEAResult
CONSULTING INC.

Applicants (Defendants in . CV-24-00718895-00CL)

– and –

JASON SANTOMERO, KATHY SANTOMERO and
11168843 CANADA LTD.

Respondents (Plaintiffs in . CV-24-00718895-00CL)

REASONS FOR DECISION

KIMMEL J.

Released: November 4, 2024