Docket: 2012-4145(IT)G

BETWEEN:

BLENK DEVELOPMENT CORP.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

Motion heard on April 25, 2014, at Vancouver, British Columbia

Before: The Honourable Mr. Justice Randall S. Bocock

Appearances:

Counsel for the Appellant:	Greg J. Pratch
Counsel for the Respondent:	Bruce Senkpiel

ORDER

IN ACCORDANCE with the oral reasons for order delivered by conference call on May 20, 2014, the Appellant's motion is granted and Mr. Brad Rolph may attend as an expert at the Appellant's examinations for discovery of the Respondent's representative subject to the following:

1. Mr. Rolph shall sign an express covenant addressed to the Respondent and this Court agreeing to comply with the implied undertaking rule; with such form to be drafted by Respondent's counsel to the reasonable satisfaction of Appellant's counsel;

2. The expert shall ask no direct questions nor shall he speak during the official examination process;

3. Any assistance provided by the expert to counsel shall be delivered in advance, by inconspicuous notes during the official examination process or during off the record and regularly scheduled breaks; and,

4. Costs on the motion are fixed at $1,000 and awarded to the Appellant, but reserved as to the event of the cause or as addressed when raised by counsel before any case management judge or trial judge of this Court should Mr. Brad Rolph seek to be an expert witness at trial and his ability to be an expert witness is challenged.

Signed at Ottawa, Ontario, this 23rd day of May 2014.

"R.S. Bocock"

Bocock J.

Citation:2014TCC185
Date:20140604
Docket: 2012-4145(IT)G

BETWEEN:

BLENK DEVELOPMENT CORP.,

Appellant,

and

HER MAJESTY THE QUEEN,

Respondent.

REASONS FOR ORDER

(Delivered orally from the bench on May 20, 2014, in Ottawa, Ontario.)

Bocock J.

[1] These reasons for order are delivered orally this May 20, 2014, after review and deliberation in respect of a motion brought relating to matter 2012-4145(IT)G between *Blenk Development Corp. and Her Majesty The Queen* at Vancouver, British Columbia on the 25th day of April, 2014.

[2] The Appellant, Blenk Development Corp. ("Blenk"), brings this motion for an order of this Court to permit an expert to attend at the examinations of discovery by the Appellant of the Respondent's representative.

[3] The Minister reassessed Blenk and disallowed deductions for interest expenses claimed under paragraph 20(1)(*c*) of the *Income Tax Act* (the "*Act*"). The deduction was disallowed on the basis that the rate of interest utilized by Blenk on a non-arm's length loan transaction, involving a friend of the 100% shareholder principal of Blenk, was unreasonable given the Minister's assumed terms and conditions, timing and the market risks associated with the loan (the "comparative factors"). The deduction has also been denied through assumptions relating to the non-existence of the debt and loan in the first instance and its characterization as a sham.

[4] In the Amended Reply, the Minister specifically assumes that the terms and conditions, timing and market risks associated with the alleged loan, when analyzed on a comparative basis, dictate that financial institutions, both foreign

and/or domestic, would have provided similar loans at appreciably diminished rates of interest (the "economic analysis"). After conducting the economic analysis of the loans, the rates of interest were assumed to be inflated and the interest expense deduction was disallowed. This is cumulatively reflected, *inter alia*, in subparagraphs 26(oo) through (aaa) of the Amended Reply. Specifically, the Court references the following subparagraphs:

> oo) Gerhard Blenk would not have been risky customer to a Canadian bank;
>
> pp) the alleged loans were filly secured by the assets owned by the Appellant and by a personal guarantee from Gerhard Blenk;
>
> qq) Gerhard Blenk's personal guarantee for the amounts allegedly borrowed would have secured mush better interested rates for the alleged loans than those set out in the purported loan agreements;
>
> rr) the default rate for loan personally pledged by Gerhard Blenk is zero;
>
> ss) a Canadian bank would have been willing to lend the Appellant the amounts allegedly borrowed for the prime business rate;
>
> ss) a Canadian bank would be willing to resolve the alleged loans from one development phase of the Wilden development to another under the same terms and conditions;
>
> […]
>
> zz) Herhard Blenk could have borrowed the amounts allegedly borrowed from banks in Germany and Liechtenstein at reasonable interest rates;
>
> aaa) Herhard Blenk could have borrowed the amounts allegedly borrowed from banks in Germany and Liechtenstein below the prime rate;
>
> […]

[5] Counsel for the Appellant argues that the knowledge of the methodology, definition and application of the comparative factors and ensuing economic analysis is beyond the legal skill and knowledge normally expected of legal counsel and may impede Appellant counsel's ability to conduct a proper

examination without the assistance and presence of an expert at examination for discoveries.

[6] In opposing the motion, Respondent's counsel submits that the Appellant has failed to meet the required onus for three reasons:

a. no evidence is before the Court that Appellant counsel's level of skill and knowledge is exceeded by the comparative factors and economic analysis to such a level where proper examinations for discovery cannot take place without the presence of an expert;

b. the question of the reasonableness of the rate of interest, while requiring an economic analysis of comparative factors is at the very low end of complexity of such a transfer pricing scenario, includes a relatively simple fact situation and, even at that, involves only a small component of this otherwise factually based appeal; and,

c. the law in respect of the role of expert witnesses generally has undergone recent changes by virtue of evolving case law and by amendments to the Tax Court of Canada's own rules which now arguably disqualify an expert from examinations for discovery and/or trial where an "advocacy" role is likely to be adopted.

[7] Prior to an expanded analysis of the Respondent's position in this motion, a summary examination of the legal basis upon which experts may be permitted at examination for discoveries will assist the Court. Both counsel agreed on the test which has been cited with authority by the Federal Court of Canada in *S & M Brands Inc. v. Paul*, 2003 FC 1035 where at paragraph 12, Justice Blais, as he then was, referenced with approval *Ormiston v. Matrix Financial Corp*., 2002 SKQB 257, which in turn was a decision of Justice Klebuc. These general principles applicable to the question of the presence of non-parties at examination for discoveries are summarized and customized by this Court to the Tax Court of Canada as follows:

a) generally only parties and counsel may attend, unless a motion's judge grants leave for a non-party;

b) a non-exclusive list of circumstances where such discretionary leave may be granted are:

i. where the level of expert knowledge, scientific, technical or otherwise, relevant to an appeal and its underlying issues and assumptions are beyond counsel and therefore preclude proper examinations for discovery (this circumstance relevant in this motion);

ii. a non-party is seized of ability or knowledge which will assist or inform the examination for discovery process;

iii. a party requires assistance specific in the circumstances.

c) the burden is that of the party making the request and is usually satisfied by an affidavit outlining the need, concern or assistance, as the case may be; and,

d) once established factually, any prejudice or other ground for exclusion rests with the opposing party.

[8] Returning to further analysis of the Respondent's grounds for opposing the request, the Court will decide this matter with reference to the test as customized from *Ormiston* above.

[9] The Respondent argues that there is insufficient evidence before the Court to afford a conclusion that Mr. Fellhauer, counsel of record, lacks knowledge beyond that reasonably expected in order to conduct a proper examination. Factually, counsel says there is no sworn testimony before the Court of Mr. Fellhauer's knowledge, one way or the other. Legally, in relation to the appeal, the case will likely rest on factual findings of the Court rather than issues and methodology related to the economic analysis of the comparative factors. To support this argument, Respondent counsel references a previous exchange of correspondence during the objection process which it is alleged reconciled, narrowed and answered question relating to the comparative factors and economic analysis.

[10] As to this first assertion, the Court is not convinced. Mr. Pratch, who appeared as counsel on this motion, on the cross-examination of the affiant's affidavit and has otherwise appeared throughout the process to date, represented directly to the Court that he will appear on discoveries. He also stated that the underlying assumptions related to the intricacies of the comparative factors and economic analysis are beyond a standard reasonably expected of general litigation counsel. Further the affiant, whose credentials as an expert in this file are of

national rank, has attested to the fact that such understanding comes after years of study, practice and experience in the area. This assertion was not challenged on cross-examination. The Court finds that the use of the comparative factors and economic analysis are not regularly included in the general practice of law and general tax litigation.

[11] Now, to the second point that the comparative factors and economic analysis are no longer meaningfully in dispute, the Court again must reference the affiant's testimony that a critical part of the assumptions in the Amended Reply require reference to a "transfer pricing model" engaging OECD and CRA publications to guide the economic analysis of the comparative factors. Whether Respondent's counsel is correct or not that this issue has been resolved is neither plain and obvious nor readily apparent from the evidence before this motions Court. A trial judge may well determine this is true, but that is not the role or within the capacity of this motions Court, given the considerable reference, pleadings and argument to date related to this issue.

[12] Respondent's counsel also asserts that even if the test involves some transfer pricing principles engaging the analysis of whether the interest expense deduction was reasonable, the present appeal is among the simplest of such cases and lacks the complexity which requires an expert at examinations for discovery. The two types of published guidance, the CRA IC 87-2R and the OECD Transfer Pricing Guidelines have existed for some time and will apply without little methodological variation. In any event, such application will likely be neatly dealt with at trial by respective expert testimony as to the comparative factors and quantum. Respondent's counsel argues that the remaining balance of the issues to be determined at trial, which are the largest volume, are factual and fall to the Court, not experts.

[13] The Court certainly agrees with Respondent's counsel that the determination of a reasonable rate of interest in relation to the disallowed interest expense is not the sole issue which will be before the Court: mere reference to the Notice of Appeal and Amended Reply provide that *prima facie* evidence.

[14] The Court disagrees with the position that the determination of reasonableness, because it is a standard used frequently in the *Act* and before the Court, has a level of familiarity, simplicity and common experience in this context to render such a determination simple. The deployment of that standard when combined with the Respondent's own assumptions, underlying analysis and conclusions in the amended Reply make it deceivingly simple.

[15] On the face of the evidence before the Court, in arriving at the reassessing position, the Minister utilized the services of the CRA International Tax Directorate's own on-staff economist. The report generated was on its face the basis for the factual assumptions regarding the unreasonable, unrestrained and artificial interest rates allegedly used by the Appellant. The Respondent has referenced that report, amendments and subsequent updates as and when needed. Apart from that point, the methodology of a transfer pricing model was used and forms a critical part of one the bases upon which the interest expense was disallowed, albeit, at its generically highest level as being "unreasonable". The comparative factors and the economic analysis of same to disallow the Appellant's claimed interest expense deduction embed the requirement of such expert knowledge in one of the issues in dispute before the Court in this appeal. Subject to the restrictions which follow, the need, concern of counsel and nature of assistance are established sufficiently to warrant the presence of the sought expert at examinations for discovery.

[16] The final basis for opposing the presence of the expert involves recent developments in the case law and this Court's own rules. Respondent's counsel by referencing the different emphasis taken by various provincial superior courts has suggested that the more recent standard is to exclude from presence at the discovery process an expert who may testify at trial.

[17] In digested form, the range of the case law may be summarized as follows: the exclusion of an expert at discoveries from being an expert witness at trial is possible, but it is difficult to imagine when such an order would be proper: *Ian MacDonald Library Services Ltd. v. P.Z. Resort Systems Inc.*, 1985 CanLii 259 at paragraph 15. In considering the argument of prejudice arising from the dual role of an expert at examinations for discovery and at trial, the motion judge need not overly confront such an issue because qualification for each separate stage embodies a different standard and different role: *Ormiston*, supra at paragraph 24. Where a Court's rules impose an *amicus curiae* role for experts, numerous substantive, private discussion, meetings and expert report revisions will disqualify an expert witness at trial: *Blake Moore v. Dr. Tajedin Getahun*, 2014 ONSC 237 at paragraphs 50, 51 and 53. While the final case involved excessive causal conclusions in medical-legal testimony, the Court in *Blake Moore* did reference a portion of the *Ontario Rules of Civil Procedure Rule* 53.03. That *Rule* provides the following form as an expert's duty to the Court:

> […]

> (a) to provide opinion evidence that is fair, objective and non-partisan;
>
> (b) to provide opinion evidence that is related only to matters that are within my area of expertise, and;
>
> (c) to provide such additional assistance as the court may reasonably require, to determine a matter in issue.
>
> […]

[18] Respondent's counsel contends the foregoing rule is roughly analogous to the Tax Court of Canada's own recent rule amendments and, specifically, subsection 145(1) of the *Tax Court of Canada Rules* (*General Procedure*) and the Expert Witness Code of Conduct which provide, *inter alia*:

> 145. (1) In this section, "expert report" means
>
> (a) a solemn declaration made by a proposed expert witness under section 41 of the Canada Evidence Act; […]
>
> (2) An expert report shall
>
> (a) set out in full the evidence of the expert;
>
> (b) set out the expert's qualifications and the areas in respect of which it is proposed that they be qualified as an expert witness; and
>
> (c) be accompanied by a certificate in Form 145(2) signed by the expert acknowledging that they have read the Code of Conduct for Expert Witnesses set out in Schedule III and agree to be bound by it.
>
> SCHEDULE III
> CODE OF CONDUCT FOR EXPERT WITNESSES
>
> General Duty to the Court
>
> 1. An expert witness has an overriding duty to assist the Court impartially on matters relevant to his or her area of expertise.
>
> 2. […]. An expert witness must be independent and objective and must not be an advocate for a party.
>
> Expert Reports

> 3. An expert report shall include […]
>
> (d) the facts and assumptions on which the opinions in the report are based;

[19] In concluding, counsel for the Respondent asserts the expert's presence at the examination for discoveries in this matter will transform the expert into an advocate, and given the possibility he may be an expert witness at trial, taint the required independent and objective duty outlined in this Court's Expert Witness Code of Conduct ("Expert Code of Conduct").

[20] The Respondent's arguments and submissions on this point have some merit. They are also premature and otherwise generally mitigated by the imposition of certain procedural requirements at this stage.

[21] The new Expert Code of Conduct relates specifically to an expert's preparation and subsequent testimony regarding an expert's report. Any arguments to be marshalled by a party against a proposed expert witness report logically arise when and if the report is served on opposing counsel. The case of *Blake Moore* dealt with an inappropriate expert report arising from "strategic" revisions and causal, factual conclusions, rather than exclusion on the basis of the expert's presence at examinations for discovery. Moreover, inappropriate or erroneous factual assumptions in any export report or testimony are anathema to credibility and are the veins of gold mined by opposing counsel in cross-examination. However, to the extent this expert witness who shall be present at examinations for discovery seeks to be an expert witness at trial, then, in such an event a case management judge may deal with this argument of prejudice and non-compliance with the Expert Code of Conduct at that time. The content and context of the expert report will be central to that determination precisely as such issues were in *Blake Moore*. As such, the Respondent's rights and the Court's procedures on that point will be protected.

[22] As to the expert's transformation to advocate and the protection by the Court of its processes, namely examinations for discovery, the Court observes the following: the purpose of the expert at examination for discoveries is for Appellant counsel's assistance only and not to provide a distraction, deploy an extra advocate or gain any advantage. In short, in participating solely in that role, the expert should be seen, but not heard during the official proceedings.

[23] For the foregoing reasons, the motion is granted and the expert, Mr. Brad Rolph, shall be permitted to attend the Appellant's examinations for discovery of the Respondent's representative provided that:

a. Mr. Rolph shall sign an express covenant addressed to the Respondent and this Court agreeing to comply with the implied undertaking rule; with such form to be drafted by Respondent's counsel to the reasonable satisfaction of Appellant's counsel;

b. the expert shall ask no direct questions nor shall he speak during the official examination process; and,

c. any assistance provided to counsel shall be delivered in advance, by inconspicuous notes during the official examination process or during off the record and regularly scheduled breaks.

[24] Given the nature of the motion, costs are fixed at $1,000.00 in favour of the Appellant, but are reserved as to payment in the event of the cause, or, as addressed further, when raised by counsel, before any case management or trial judge of this Court in the event that an issue is raised concerning prejudice caused by an expert report subsequently served and authored by the same expert, Mr. Rolph.

Signed at Ottawa, Ontario, this 4th day of June 2014.

"R.S. Bocock"

Bocock J.

CITATION:	2014TCC185
COURT FILE NO.:	2012-4145(IT)G
STYLE OF CAUSE:	BLENK DEVELOPMENT CORP. AND THE QUEEN
PLACE OF HEARING:	Ottawa, Ontario
DATE OF HEARING:	May 20, 2014
REASONS FOR ORDER BY:	The Honourable Mr. Justice Randall S. Bocock
DATE OF ORDER:	June 4, 2014

APPEARANCES:

Counsel for the Appellant:	Greg J. Pratch
Counsel for the Appellant:	Bruce Senkpiel

COUNSEL OF RECORD:

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