Clerk's stamp:

COURT FILE NUMBER	1801-04745
COURT	**COURT OF QUEEN'S BENCH OF ALBERTA**
JUDICIAL CENTRE	**CALGARY**
PLAINTIFF	**HILLSBORO VENTURES INC.**
DEFENDANT	**CEANA DEVELOPMENT SUNRIDGE INC.**
DOCUMENT	**BRIEF OF 1785337 ALBERTA LTD., RAHUL KAPOOR, SACHIN SARNA, SUKDHEEP S. DHALIWAL, MANDEEP S. MAVI; 1695411 ALBERTA LTD. AND JASBIR S. MUNDI**
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	Field LLP 400, 444 – 7 Avenue S.W. Calgary AB T2P 0X8 Lawyer: Douglas S. Nishimura Phone Number: (403) 260-8548 Fax Number: (403) 264-7084 File No. 69701-1

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INTRODUCTION

1. The following are written submissions on behalf of 1785337 Alberta ltd., Rahul Kapoor, Sachin Sarna, Sukdheep S. Dhaliwal, Mandeep S. Mavi; 1695411 Alberta Ltd. and Jasbir S. Mundi (collectively referred to as the "**Applicants**") with respect to an Application for a declaration that the Project (as defined in paragraph 5 of the Affidavit of Keith Ferrel sworn October 26, 2020 ("**Ferrel Affidavit**") is Ceana with a trust in favor of the Applicants.

FACTS

2. The Applicants entered into PSAs ("**PSA**") with Ceana Development Sunridge Inc. ("**Ceana**") for Units in the Project. Pursuant to the PSA's, which were identical, except for Unit description, price and closing date, deposits were paid. Pursuant to the PSA's, the deposits were to be held in trust with Ceana's counsel. The PSAs all referred to s. 14 of the *Condominium Property Act* (Alberta) in this regard.

Affidavit of Rahul Kapoor sworn June 24, 2020 ("**Kapoor Affida**vit"), Exhibit A

Affidavit of Sukhdeep S. Dhaliwal sworn October 28, 2020 ("**Dhaliwal Affidavit**"), Exhibit A

Affidavit of Jasbir S. Mundi sworn November 23, 2020 ("**Mundi Affidavit**"), Exhibit A

3. The details of the deposits paid by each Applicant are set forth in their respective Affidavits and can be summarized as follows:

   (a) 1785337 Alberta Ltd., Rahul Kapoor and Sachin Sarna - $457,487.00;

   (b) Sukhdeep S. Dhaliwal and Mandeep S. Mavi - $438,465.63; and

   (c) 1695411 Alberta Ltd. and Jasbir S. Mundi - $113,000.00.

4. The Project is Ceana's principal and only business.

Ferrel Affidavit, para 5

5. At all times, the sole directing mind of Ceana was Bahadur (Bob) Gaidhar ("**Gaidhar**"). He personally negotiated and signed each PSA.

Affidavit of Bahadur (Bob) Gaidhar sworn November 23, 2020 ("**Gaidhar Affidavit**"), para 23

6. At all material times, Ceana's Lender, Hillsboro Ventures Inc. ("**Hillsboro**") was aware that Ceana had entered into the PSAs and had reviewed the same. Further, Hillsboro was aware of the precise deposits paid by the Applicants. Hillsboro was also aware that these deposits had not been placed into trust with Ceana's counsel, but rather were held by Ceana.

Transcript from the Questioning of Keith Ferrel
held October 29, 2020 ("**Ferrel Transcript**"), pp 18-20 and 22
and Undertakings 3, 4 and 7

7. Hillsboro's loan documents provided that Hillsboro would be kept apprised of all financial matters, including presales such as the Applicants' PSAs. The loans further provided that Ceana would contribute "equity" into the Project. Hillsboro, through it knowledge of Ceana's finances, should have known that the only funds available to Ceana aside from those lent by Hillsboro and Ceana's first charge Lender, would have been from investors in Ceana and from deposits of purchasers.

Ferral Affidavit

Ferrel Transcript, supra, p. 30

8. Gaidhar has confirmed under oath that the deposit funds of the Applicants were not placed into trust with Ceana's counsel, but rather were used by Ceana solely in respect of the Project. This evidence is uncontradicted.

Gaidhar Affidavit, paras 30-31

ISSUE

9. The sole issue to be determined in this Application is whether the Project is impressed by a trust in favor of the Applicants with respect to their deposits.

ARGUMENT

10. It is clear that a trust was created pursuant to the PSAs. The PSAs provide expressly that all deposits would be held in trust.

11. Further, s. 14 of the *Condominium Property Act* requires a developer of a condominium to hold in trust all monies paid by the purchaser of the unit up to the time that a certificate of title to a

unit position coming in the name of the purchaser in accordance with the purchase agreement. Such statutory trusts have been recognized in Alberta.

Condominium Property Act, s. 14 [**TAB 1**]

Iona Contractors Ltd. v. Guarantee Company of North America [2015] ABCA 240, at paras 21 and 49 [**TAB 2**]

12. In addition to the express trust under the PSAs and pursuant to the *Condominium Property Act*, it is submitted that a constructive trust in favor of the Applicants was created when Ceana failed to deposit the trust fund into its solicitor's account, as mandated by the PSA, and instead used the funds for the Project. This was the case in *Morris Waxman et al v. Chester Waxman et al*. In *Waxman*, a constructive trust was ordered where the defendant had misused trust property.

Morris Waxman et al v. Chester Waxman et al [2002] CanLII 20932 (ONSC) at para 8 [**TAB 3**]

13. Similarly, in *Re: Credifinance Securities Limited*, the Court found that misuse of investment funds created a constructive trust in favor of the plaintiffs.

Re: Credifinance Securities Limited [2010] ONSC 984 CanLII, at paras 23 and 32 [**TAB 4**]

14. It is trite law that a constructive trust is created where there is unjust enrichment, consisting of enrichment of one party, deprivation to the other party, and no juristic reason for the enrichment. Here, Ceana (and arguably other parties with an interest in the Project) have been enriched, the Applicants have been deprived of their deposit funds, and there is no juristic reason for the enrichment.

15. It is anticipated that the Respondents to this Application will argue that any such trust interest was lost when Ceana comingled the Applicants' deposit funds. However, this is not the case, according to the jurisprudence. In *Waxmax, supra*, the Court cited, M. Ellis "Fiduciary Duties in Canada" as follows:

> Clearly the most powerful of the fiduciary remedies is that of declaration of trust. By finding out that the fiduciary has breached the duty owed, the Court may hold that the defaulting party must account to the beneficiary <u>for the product of the breach</u>. [Emphasis added] This concept stems from the trust beneficiary obligation that the former not attain any personal "gain" from the relationship apart from that anticipated by the relationship itself. The prohibition therefore dictates that any such gain is not and never was lawfully in the hands of the defaulting fiduciary as its beneficial owner. The law imposes a trusteeship in the holder in favor of the party to whom the fiduciary

> owes the duty of fidelity. The "gain" is therefore legally owned by the wronged party: the fiduciary merely "holds" the gain on the other's behalf.
>
> The tracing remedy and the constructive trust declaration are extensions of the finding of trusteeship: the wronged party may "trace" the gain into a mixed fund and/or by-products of the gain in altered form…

Waxman, supra, at para 31

16. The Court in *Waxman, supra*, further quoted, with approval as follows:

> I am asked to take only one step forward, to answer the initial question of principle: whether the claimant is entitled inequity to trace the mistake in payment and to recover what now properly represents the money… I will direct an inquiry of what is become of that sum and what assets, if any, in the possession or power of the defendant now represent the said sum any part thereof, or any interest or income thereof.

17. To similar effect, the Ontario High Court of Justice dealt with the alteration of trust funds into other property in *Re: Ontario Securities Commission and Greymac Credit Corp.* The Court stated:

> "It is trite law that, at that time, the Participants and the companies could have traced their funds into both the mingled fund and the separate account. In Re Hallett's Estate, Jessel M.R. stated at p. 719:
>
> > But so long as the trust property can be traced and followed into other property into which it has been converted that remains subject to the trust.
>
> Furthermore, Joyce J. stated in *Re Oatway; Hertslet v. Oatway*, [1903] 2 Ch. 356 at pp. 359-60:
>
> > Trust money may be followed into land or any other property in which it has been invested; and when a trustee has, in making any purchase or investment, applied trust money together with his own, the cestuis que trust are entitled to a charge on the property purchased for the amount of the trust money laid out in the purchase or investment.

Re: Ontario Securities Commission and Greymac Credit Corp. [1985] CanLII 2201 (ON SC), at p. 13 [**TAB 5**]

18. To similar effect, the Saskatchewan Court of Appeal held, in *Agricultural Credit Corp. of Saskatchewan v. Pettyjohn*, that trust property may be traced into proceeds or other property acquired by use of the trust funds. The Saskatchewan Court of Appeal Waters *Law of Trusts in Canada* as follows:

> They [the funds] may still be traceable if the donee spent the loan on the acquisition of an asset which he still has, but in this case the trust funds would effectively have been converted into the asset in question.

Agricultural Credit Corp. of Saskatchewan v. Pettyjohn, 1991 CanLII 7979 (SK CA), at para 59 [**TAB 6]**

19. In this case, the uncontradicted evidence of the Applicants and Gaidhar is that the Applicants' deposit funds were used solely for the Project.

20. It is further clear that the trust interest will take priority as against third parties with notice of the claim. In *Waxman, supra*, the Court cited *Foskett v. McKeown*, with approval as follows:

> A beneficiary of a trust is entitled to a continuing beneficial interest not merely in the trust property but in its traceable proceeds also, and his interest binds everyone who takes the property or its tracable proceeds except a *bona fide* purchaser for value without notice.

Waxman, supra, at para 31

21. In the present case, it is clear that Hillsboro was aware that deposit funds were held by Ceana and in particular, the deposit funds of the Applicants. Accordingly, Hillsboro cannot be said to be a *bona fide* purchaser (or in this case Lender) for value without notice.

22. It is submitted that a trust interest is a hollow right if, simply by dispersing the trust funds or converting those funds into other property, the beneficiary can lose its trust interest both to the defaulting party and to other parties who had notice of the existence of the trust. Therefore, in this Court's equitable jurisdiction and pursuant to the jurisdiction set forth in the *Condominium Property Act*, this Court can impose a constructive trust against the project to the extent of the deposits.

23. This result is not unfair to the other parties, since the deposit funds were used to improve the project for the benefit of all parties.

CONCLUSION

24. In summary:

    (a) An express trust was created pursuant to the PSA's and the *Condominium Property Act*;

    (b) The Applicants are also entitled to a constructive trust based on the failure or breach by Ceana to hold the funds in trust;

(c) Both the express trust and constructive trust interests can be traced directly into the Project; and

(d) The trust interest takes priority to Hillsboro, as a party who had notice of the PSA (and its trust provisions regarding the deposit of the Applicants).

RELIEF REQUESTED

25. For the foregoing reasons, the Applicants request:

(a) An Order that the Project is impressed with an express and/or constructive trust in favor of the Applicants;

(b) A direction that any sale of the Project shall be subject to the trust interest set forth above;

(c) A direction that the proceeds of any sale of the Project are further impressed with the trust to the benefit of the Applicants;

(d) A direction for costs of this matter, payable by any party in opposition to the Application, jointly and severally; and

(e) Such further and other relief as counsel may seek.

Submitted this 2nd day of December, 2020.

ALL OF WHICH IS RESPECTFULLY SUBMITTED

FIELD LLP

Per: ______________________________

Douglas S. Nishimura, solicitor for 1785337 Alberta ltd., Rahul Kapoor, Sachin Sarna, Sukdheep S. Dhaliwal, Mandeep S. Mavi; 1695411 Alberta Ltd. and Jasbir S. Mundi

TABLE OF AUTHORITIES

1. *Condominium Property Act,* R.S.A. 2000 Chapter C-22, s. 14

2. *Iona Contractors Ltd. v. Guarantee Company of North America* [2015] ABCA 240

3. *Morris Waxman et al v. Chester Waxman et al* [2002] CanLII 20932 (ONSC)

4. *Re: Credifinance Securities Limited* [2010] ONSC 984 CanLII

5. *Re: Ontario Securities Commission and Greymac Credit Corp.* [1985] CanLII 2201 (ON SC)

TAB 1

Province of Alberta

CONDOMINIUM PROPERTY ACT

Revised Statutes of Alberta 2000
Chapter C-22

Current as of July 23, 2020

Office Consolidation

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Suite 700, Park Plaza
10611 - 98 Avenue
Edmonton, AB T5K 2P7
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Note

All persons making use of this consolidation are reminded that it has no legislative sanction, that amendments have been embodied for convenience of reference only. The official Statutes and Regulations should be consulted for all purposes of interpreting and applying the law.

Amendments Not in Force

This consolidation incorporates only those amendments in force on the consolidation date shown on the cover. It does not include the following amendments:

2014 c10 s2 amends s1; s17 repeals and substitutes s26 and adds ss26.1 to 26.8; s27(a) (2015 c12 s8 - effective January 1, 2019) amends s36, s30 adds ss39(2)(b) and (c); s46 amends s69; s47 adds ss69.1 to 69.9; s55 amends s81; s58 amends ss26(6)(b) and 28.1(1)(c).

Regulations

The following is a list of the regulations made under the *Condominium Property Act* that are filed as Alberta Regulations under the Regulations Act

	Alta. Reg.	*Amendments*
Condominium Property Act		
Condominium Property	168/2000	*23/2001, 354/2003, 108/2004, 221/2004, 151/2006, 103/2011, 139/2016, 181/2017,*

148/2018, 256/2018,
81/2019, 154/2019,
85/2020

HER MAJESTY, by and with the advice and consent of the Legislative Assembly of Alberta, enacts as follows:

Interpretation

1(1) In this Act,

(a) repealed 2014 c10 s2;

(b) "bare land unit" means a unit defined in clause (y)(ii);

(c) "board" means the board of a corporation as provided for in section 28 and, except in sections 17(2), 17.1, 28 and 29, includes an interim board;

(d) "building" means one or more buildings on the same parcel;

(e) "bylaws" means the bylaws of a corporation as amended from time to time and includes any bylaws passed in substitution for them;

(f) "common property" means so much of the parcel as is not comprised in a unit shown in a condominium plan, but does not include land shown on the condominium plan that has been provided for the purposes of roads, public utilities and reserve land under Part 17 of the *Municipal Government Act*;

(g) "condominium plan" means a plan registered in a land titles office that complies with section 8 and includes any amendment to a condominium plan referred to in section 18 or 20, any plan or condominium plan, as the case may be, relating to development in phases referred to in section 19 or any plan or condominium plan, as the case may be, relating to redivision referred to in section 20 that is registered in the land titles office;

(g.1) "contribution" means an amount levied under section 39;

(g.2) "conversion" means a condominium plan in which is illustrated an existing building that, at any time before the registration of the condominium plan, was occupied in whole or in part by any person, including a tenant, other than

(i) a purchaser of a unit to be created by the registration of the condominium plan, or

(ii) a person occupying the building or any part of it for the sole purpose of marketing the units to be created by the registration of the condominium plan;

(g.3) "conversion unit" means a unit in a conversion;

(h) "corporation" means a body incorporated by section 25;

(i) "Court" means the Court of Queen's Bench;

(j) "developer" means a person who, alone or in conjunction with other persons, sells or offers for sale to the public units or proposed units that have not previously been sold to the public by means of an arm's length transaction;

(j.1) "Director" means an individual designated by the Minister as the Director for the purposes of this Act and the regulations;

(k) repealed 2014 c10 s2;

(k.1) "general meeting" means an annual general meeting referred to in section 30 and a special general meeting referred to in section 30.1;

(k.2) "interim board" means the interim board of directors appointed under section 10.1;

(l) "land surveyor" means an Alberta land surveyor registered, or the holder of a permit issued, under the *Land Surveyors Act*;

(m) "landlord" means an owner of a unit that is being rented and includes a person acting on behalf of the owner;

(m.1) "managed property" means any unit or part of a unit that a corporation is required by bylaw to maintain, repair or replace, other than the real and personal property of the corporation and the common property;

(n) "management agreement" means an agreement entered into by a corporation governing the general control, management and administration of

(i) the real and personal property of the corporation,

(ii) the common property, and

(iii) managed property;

(o) "Minister" means the Minister determined under section 16 of the *Government Organization Act* as the Minister responsible for this Act;

(p) "municipal authority" means

(i) a municipal authority as defined in the *Municipal Government Act*, or

(ii) in the case of a national park other than a town within a national park to which subclause (i) applies, the Minister of the Crown in right of Canada charged with the administration of the *National Parks Act* (Canada);

(q) "municipality" means the area of a city, town, village, municipal district, improvement district, special area or national park;

(r) "ordinary resolution" means a resolution

(i) passed at a properly convened meeting of a corporation by a majority of all the persons present or represented by proxy at the meeting entitled to exercise the powers of voting conferred by this Act or the bylaws, or

(ii) signed by a majority of all the persons who, at a properly convened meeting of a corporation, would be entitled to exercise the powers of voting conferred by this Act or the bylaws and representing more than 50% of the total unit factors for all the units;

(s) "owner" means a person who is registered as the owner of

(i) the fee simple estate in a unit, or

(ii) the leasehold estate in a unit when the parcel on which the unit is located is held under a lease and a certificate of title has been issued under section 5(1)(b) in respect of that lease;

(t) "parcel" means the land comprised in a condominium plan;

(t.1) "prescribed" means prescribed or otherwise provided for in the regulations;

(t.2) "professional engineer" means a professional engineer as defined in the *Engineering and Geoscience Professions Act*;

(t.3) "professional technologist" means a professional technologist as defined in section 86.4(m) of the *Engineering and Geoscience Professions Act*;

(u) "purchase agreement" means an agreement with a developer whereby a person purchases a unit or proposed unit or acquires a right to purchase a unit or proposed unit;

(u.1) "recorded mail" means a form of document delivery by mail or courier in which receipt of the document must be acknowledged in writing;

(v) "recreational agreement" means an agreement entered into by a corporation that allows

(i) persons, other than the owners, to use recreational facilities located on the common property, or

(ii) the owners to use recreational facilities not located on the common property;

(v.1) "registered architect" means a registered architect as defined in the *Architects Act*;

(w) "residential unit" means

(i) in the case of a unit that is situated within a building, a unit that is used or intended to be used for residential purposes, and

(ii) in the case of a bare land unit, a unit that is used or intended to be used for residential purposes or that has been represented by a developer as being intended to be used for residential purposes;

(x) "special resolution" means a resolution

(i) passed at a properly convened meeting of a corporation by a majority of not less than 75% of all the persons entitled to exercise the powers of voting conferred by this Act or the bylaws and representing not less than 75% of the total unit factors for all the units, or

(ii) agreed to in writing by not less than 75% of all the persons who, at a properly convened meeting of a corporation, would be entitled to exercise the powers of voting conferred by this Act or the bylaws and representing not less than 75% of the total unit factors for all the units;

(y) "unit" means

(i) in the case of a building, a space that is situated within a building and described as a unit in a condominium plan by reference to floors, walls and ceilings within the building, and

(ii) in the case other than that of a building, land that is situated within a parcel and described as a unit in a condominium plan by reference to boundaries governed by monuments placed pursuant to the provisions of the *Surveys Act* respecting subdivision surveys;

(z) "unit factor" means the unit factor for a unit as specified or apportioned in accordance with section 8(1)(j) or 20(6), as the case may be.

(2) In this Act a reference to an arm's length transaction or to a transaction being at arm's length is a reference to a transaction that is conducted in an open market between willing parties to the transaction negotiating in their own respective self interest where the consideration paid is competitive and not unreasonable having regard to open market conditions.

(3) Other expressions used in this Act and not defined in subsection (1) have the same meanings as may be assigned to them in the *Land Titles Act*.

RSA 2000 cC-22 s1;2011 c3 s33;2014 c10 s2

Municipal Government Act applies

2(1) Part 17 of the *Municipal Government Act* applies to any building or land that is subject to a condominium plan or a proposed condominium plan or in respect of which a condominium plan is terminated.

(2) Notwithstanding subsection (1), the provisions of Part 17 of the *Municipal Government Act* relating to the subdivision of land do not apply to the division of a building under a condominium plan if

(a) the surface boundaries of the parcel as defined in this Act on which that building is located correspond to the boundaries of a parcel of land as defined in Part 17 of the *Municipal Government Act*, and

(b) each building located on the parcel that contains a unit contains 2 or more units.

1983 c71 s3;1995 c24 s100

Plan of subdivision

3 For the purposes of Part 17 of the *Municipal Government Act* and the *Land Titles Act*, a condominium plan is a plan of subdivision.

1983 c71 s3;1995 c24 s100

Act prevails

13.2 Any waiver or release by a purchaser of the rights, benefits or protections under this Act is void.

2014 c10 s6

Payments held in trust

14(1) For the purposes of this section,

(a) "common property" includes facilities and property that are intended for common use by the owners notwithstanding that the facilities or property may be located in or comprise a unit or any part of a unit;

(b) "cost consultant" means a person who meets the requirements of the regulations to be a cost consultant or is otherwise designated as a cost consultant pursuant to the regulations;

(c) "developer" includes any person who, on behalf of a developer, acts in respect of the sale of a unit or a proposed unit or receives money paid by or on behalf of a purchaser of a unit or a proposed unit pursuant to a purchase agreement;

(d) "financial institution" means a bank, treasury branch, credit union or trust corporation;

(e) "substantially completed" means, subject to the regulations,

(i) in the case of a unit, when the unit is ready for its intended use, and

(ii) in the case of related common property, when the related common property is ready for its intended use.

(2) A reference in this section to "related common property" is, in relation to a unit, a reference to the following:

(a) the common property or a portion of the common property that is necessarily incidental to the completion of the unit;

(b) the common property or a portion of the common property that is necessarily incidental to the intended use of the unit;

(c) in the case of a unit other than a bare land unit, the common property or a portion of the common property consisting of

(i) utilities required to service the unit and the common property,

(ii) a facility providing for reasonable access to or entrance into the unit,

(iii) a facility providing for reasonable access to highways, municipal roads or streets,

(iv) waste removal facilities or other facilities for handling waste, and

(v) any other improvements or areas

(A) designated by the regulations, or

(B) required under any other Act or regulations,

that are necessarily incidental to the intended use of the unit;

(d) in the case of a unit other than a bare land unit, in addition to the common property referred to in clauses (a) to (c), any common property or any portion of the common property that has been represented in the purchase agreement by the developer as being or as going to be available for the use of the owner of the unit and, without limiting the generality of the foregoing, may include one or more of the following:

(i) roadways, parking areas and walkways;

(ii) fences or similar structures;

(iii) landscaped areas and site lighting;

(e) in the case of a bare land unit, the common property or a portion of the common property consisting of

(i) a facility providing for reasonable access to or entrance into the unit,

(ii) a facility providing for reasonable access to highways, municipal roads or streets, and

(iii) any other improvements or areas

(A) designated by the regulations, or

(B) required under any other Act or regulations,

that are necessarily incidental to the intended use of the unit;

(f) in the case of a bare land unit, in addition to the common property referred to in clauses (a), (b) and (e), any common property or any portion of the common property that has been represented in the purchase agreement by the developer as being or as going to be available for the use of the owner of the unit and, without limiting the generality of the foregoing, may include one or more of the following:

(i) utilities required to service the unit and the common property;

(ii) roadways, parking areas and walkways;

(iii) fences or similar structures;

(iv) landscaped areas and site lighting;

(v) waste removal facilities or other facilities for handling waste.

(3) A developer or prescribed trustee, as the case may be, shall hold in trust all money, other than rents or security deposits, paid by the purchaser of a unit up to the time that the certificate of title to the unit is issued in the name of the purchaser in accordance with the purchase agreement.

(4) Notwithstanding subsection (3), if a unit is not substantially completed, the developer or prescribed trustee, as the case may be, shall hold in trust money, other than rents or security deposits, paid by the purchaser of the unit so that the amount of money held in trust will be sufficient, when combined with the unpaid portion of the purchase price of the unit, if any, to pay for the cost of substantially completing the construction of the unit as determined by a cost consultant.

(5) Notwithstanding subsection (3), if the related common property is not substantially completed, the developer or prescribed trustee, as the case may be, shall hold in trust money, other than rents or security deposits, paid by the purchaser of the unit so that the amount of money held in trust will be sufficient, when combined with the unpaid portion of the purchase price of the unit, if any, to pay for the proportionate cost of substantially completing the construction of the related common property as determined by a cost consultant based on the unit factors of the units sharing the same related common property.

(6) A developer who receives money that is to be held in trust under this section shall, within 3 days of receiving it, exclusive of holidays and Saturdays, deposit the money into a trust account maintained in a financial institution in Alberta.

(6.1) A trust account referred to in subsection (6) must be maintained by a prescribed trustee.

(7) A developer or prescribed trustee, as the case may be, who is in possession or control of money that is to be held in trust under this section shall ensure that the money is kept on deposit in Alberta.

(7.1) A developer or prescribed trustee, as the case may be, who is in possession or control of money that is to be held in trust under this section shall comply with the requirements respecting trust accounts established by the regulations.

(8) If money is being held in trust under this section and the purchaser of the unit takes possession of or occupies the unit prior to the certificate of title being issued in the name of the purchaser, the interest earned on that money, if any, from the day that the purchaser takes possession or occupies the unit to the day that the certificate of title is issued in the name of the purchaser is to be applied against the purchase price of the unit.

(9) Subject to subsection (8), the developer is entitled to the interest earned on money held in trust under this section.

(10) Subject to subsection (11), this section does not apply in respect of money paid to a developer under a purchase agreement if that money is held, secured or otherwise dealt with under the provisions of a plan, agreement, scheme or arrangement approved by the Minister that provides for the receipt, handling and disbursing of all or a portion of that money or indemnifies against loss of all or a portion of that money or both.

(11) Where

(a) money is to be held, secured or otherwise dealt with under the provisions of a plan, agreement, scheme or arrangement referred to in subsection (10), and

(b) an amount of that money that is to be held, secured or otherwise dealt with exceeds the limits of the protection against loss provided for under the plan, agreement, scheme or arrangement,

that amount that exceeds the limits of the protection against loss under the plan, agreement, scheme or arrangement is to be held in trust under this section.

(12) Notwithstanding subsections (3) to (11),

(a) where in relation to a unit or related common property, or both, a developer is required to provide security under another enactment for the purpose of completing construction, and

(b) that construction referred to in clause (a) is the same or substantially the same construction with respect to a unit or related common property in respect of which money is to be held in trust under this section,

the developer may, subject to the regulations, reduce the amount of money to be held in trust under this section by the amount of the security provided under the enactment referred to in clause (a).

(13) Where, with respect to a unit or related common property, or both,

(a) money is held in trust under this section or held, secured or otherwise dealt with pursuant to the provisions of a plan, agreement, scheme or arrangement approved under subsection (10), and

(b) the developer has not met the requirements under which that money is to be paid out of the trust or otherwise disbursed,

the corporation or an interested party may apply to the Court for an order for that money to be paid out for the purposes of substantially completing the unit or related common property, as the case may be, or to be used as directed by the Court.

(14) On hearing an application under subsection (13), the Court may do one or more of the following:

(a) give directions as to whom the money is to be paid;

(b) give directions as to how the money is to be used for the purposes of substantially completing the unit or related common property, or both, as the case may be;

(c) give directions as to how the money is to be used or otherwise disposed of if it is not to be used for the purposes referred to in clause (b);

(d) appoint an administrator, a receiver or a receiver and manager for the purpose of carrying out any matters dealt with pursuant to the application;

(e) give any other directions, not referred to in clauses (a) to (d), that the Court considers appropriate in the circumstances;

(f) award costs.

(15) Once the unit or the related common property, or both, as the case may be, in respect of which money is being held in trust under this section are, as determined by a cost consultant, substantially completed, any money remaining in trust may be paid to the developer.

RSA 2000 cC-22 s14;2014 c10 s7

Exemption

15 Section 14 does not apply if the purchaser does not perform the purchaser's obligations under the purchase agreement.

RSA 1980 cC-22 s12

Security deposit

16(1) If a purchaser of a residential unit, prior to receiving title to the unit, rents that unit from the developer, the developer may charge the purchaser a security deposit in respect of the unit.

(2) A developer shall not charge an amount under subsection (1) in excess of one month's rent for the unit.

RSA 2000 cC-22 s16; 2014 c10 s8

Documents required

16.1(1) The developer shall, at the meeting of the corporation convened under section 29, provide to the corporation without charge the original or a copy of the following documents:

(a) all warranties and guarantees on the real and personal property of the corporation, the common property and managed property;

(b) the

(i) structural, electrical, mechanical and architectural working drawings and specifications, and

(ii) as built drawings,

that exist for the real property of the corporation, the common property and managed property;

(c) the plans that exist showing the location of underground utility services, sewer pipes and cable television lines located on the parcel;

(d) all agreements to which the corporation is a party;

(e) all certificates, approvals and permits issued by a municipal authority, a person accredited by the Administrator under the *Safety Codes Act*, the Government or an agent of the

TAB 2

In the Court of Appeal of Alberta

Citation: Iona Contractors Ltd. v Guarantee Company of North America, 2015 ABCA 240

Date: 20150716
Docket: 1401-0159-AC
Registry: Calgary

Between:

Ernst & Young Inc. in its capacities as Receiver and Manager and Trustee in the Bankruptcy of Iona Contractors Ltd.

Respondent
(Applicant)

- and -

The Guarantee Company of North America

Appellant
(Respondent)

The Court:

The Honourable Madam Justice Marina Paperny
The Honourable Mr. Justice Frans Slatter
The Honourable Mr. Justice Keith Yamauchi

Reasons for Judgment Reserved of the Honourable Mr. Justice Slatter
Concurred in by the Honourable Mr. Justice Yamauchi

Dissenting Reasons for Judgment Reserved of the Honourable Madam Justice Paperny

Appeal from the Order by
The Honourable Madam Justice K.M. Eidsvik
Dated the 10th day of June, 2014
Filed on the 3rd day of July, 2014

(2014 ABQB 347, Docket: 25-1475756)

Reasons for Judgment Reserved
of the Honourable Mr. Justice Slatter

[1] This appeal relates to the entitlement to holdback funds that remain unpaid under a construction contract. The main players are:

- Iona Contractors, a now bankrupt contractor (represented by its bankruptcy trustee) that agreed to improve the north airfield for the Calgary Airport Authority;
- The Calgary Airport Authority which retained Iona, and owed the disputed sum of $997,716 remaining payable under the contract. Those funds are held in trust by the appellant's solicitors pending the resolution of this dispute;
- The appellant Guarantee Company of North America which issued a Labour and Material Payment Bond to the Airport Authority to ensure payment of Iona's obligations under the contract;
- A group of unpaid subcontractors, who Iona retained to perform work on the airfield, and who were subsequently paid out by Guarantee Company of North America under the Labour and Material Payment Bond;
- The Alberta Treasury Branches, Iona's secured creditor, which has a prior registered security interest against all of Iona's assets.

The chambers judge concluded that the Trustee in Bankruptcy of Iona Contractors was entitled to receive the unpaid funds from the Airport Authority, and to pay them to Alberta Treasury Branches: ***Iona Contractors Ltd. v Guarantee Co. of North America***, 2014 ABQB 347. The surety Guarantee Company of North America appeals.

Facts

[2] In 2009 Iona and the Airport Authority entered into a contract for the construction of improvements on the airport's north airfield. Under the contract, the Airport Authority required Iona to deliver a Performance Bond, and a Labour and Material Payment Bond to guarantee that suppliers of materials and labour to the project would be paid. The appellant Guarantee Company of North America is the surety under both bonds.

[3] By October 2010, work under the contract was substantially complete, but some of Iona's subcontractors remained unpaid. The Airport Authority withheld further payment. It used $182,869 ($105,000 + $77,869) of the remaining outstanding funds to complete deficiencies in the contract work, leaving $997,715.83 still in the Airport Authority's hands. Guarantee Company paid out $1.48 million under the Payment Bond to settle the outstanding accounts of Iona's

subcontractors. It now claims the $997,715.83 that remains unpaid under the contract to recoup these payments.

[4] In December 2010, Iona applied for protection under the *Companies' Creditors Arrangement Act*, RSC 1985, c. C-36. Iona was assigned into bankruptcy on March 18, 2011.

[5] Guarantee Company argues that it is entitled to the remaining funds as the subrogee of the subcontractors because:

(a) There is no money owed to Iona under the contract, because:

(i) Iona is in breach, and

(ii) the contract gives the Airport Authority the right to cure Iona's breaches by paying the unpaid subcontractors,

and alternatively,

(b) The remaining funds are impressed by a trust under the *Builders' Lien Act*, RSA 2000, c. B-7, s. 22.

Therefore, Guarantee Company argues, Iona's Trustee has no claim to the leftover funds.

[6] The Trustee argues that:

(a) The contract work was substantially completed, and Iona is entitled to payment of the remaining funds held back under the contract. It argues that the wording of the contract permitting the Airport Authority to cure Iona's breaches of the contract does not extend as far as paying unpaid subcontractors. In the alternative, any such payments would defeat the priority regime in the *Bankruptcy and Insolvency Act*, RSC 1985, c. B-3 and are therefore impermissible, and

(b) The trust provisions of the *Builders' Lien Act*, if they apply, would also offend the priority regime in the *Bankruptcy and Insolvency Act*, and they cannot assist the surety Guarantee Company in the circumstances.

The Airport Authority takes no position, and has paid the money into trust.

[7] The chambers judge rejected both of Guarantee Company's arguments. On the contractual argument, she held at paras. 15-6, 26 that Iona was the only party with a contractual relationship with the subcontractors, and with a duty to pay the subcontractors. The Airport Authority had no "duty" to pay subcontractors. She held further at paras. 24-5 that the ability of the Airport Authority to hold back funds "required to have the Work completed", was not wide enough to cover the payment of unpaid subcontractors.

[8] With respect to the second argument, the chambers judge held at paras. 33-4 that the statutory trust created by s. 22 of the *Builders' Lien Act* conflicted with the priority regime in the *Bankruptcy and Insolvency Act*, and so was inoperative in these circumstances. She directed that the remaining holdback funds be paid to the Trustee, generating this appeal by Guarantee Company.

<u>Issues and Standard of Review</u>

[9] The appellant Guarantee Company raises the same issues on appeal. The first issue is whether there are any funds owed to Iona under the contract, which depends on whether the Airport Authority had the ability to pay the unpaid subcontractors. The second issue is whether the trust provisions of the *Builders' Lien Act* conflict with the priority regime of the *Bankruptcy and Insolvency Act.*

[10] The standard of review of the interpretation of contracts depends on the issue raised and the legal and factual context: ***Ledcor Construction Ltd. v Northbridge Indemnity Insurance Co***., 2015 ABCA 121 at paras. 12-9. No parole evidence was introduced to suggest that the parties turned their mind to how these contractual provisions would operate in the circumstances that have arisen in this appeal. The main dispute over the meaning of the contract is now between non-parties to the contract. The proper interpretation of the contract turns largely on its wording. Whether the bare wording of the contract is, in any event, rendered inoperative because of conflict with the *Bankruptcy and Insolvency Act* is a question of law. Whether the trust provisions of the *Builders' Lien Act* are operative in these circumstances is also a question of law. The appropriate standard of review in this appeal is correctness.

<u>The Contractual Argument</u>

[11] Guarantee Company argues that, under the terms of the contract, there is no money owing to Iona. It argues that the contract allows the Airport Authority to remedy breaches of the contract by Iona, which includes paying subcontractors that Iona did not pay.

[12] This argument is premised on the definition of "Work" in the contract:

> 1.1.54 "Work" means the total construction and related services required by the Contract to be performed and Products to be supplied under the Contract, and includes <u>everything that is necessary to be done</u>, furnished or delivered by the Contractor to perform the Contract.

Clause 13.1.1 places an obligation on Iona to pay its subcontractors, and so Guarantee Company argues that this is "something that is necessary to be done" under the contract. If Iona is in breach of that part of the "Work", then the Airport Authority is entitled to cure the default under clause 6.3.3(d):

> 6.3.3 If any part of the Work is taken out of the Contractor's hands:
>
> . . .
>
> (d) the Contractor's right to any further payment that is due or accruing due (including any holdback or progress claim) for the Work taken out of the Contractor's hands is extinguished, save and except that portion (if any) which is not required by the Airport Authority to have the Work completed or to compensate it for any consequential damages or losses arising out of the taking of the Work or any part of it out of the Contractor's hands.

On this argument, if a subcontractor is not paid then the "Work" is not complete, and the Airport Authority is entitled to take paying the subcontractors "out of the Contractor's hands". If the Airport Authority pays the subcontractors directly, it can deduct the funds so used from what is otherwise owing to Iona.

[13] The Trustee does not accept this line of argument, primarily because it notes that there is no contractual relationship between the Airport Authority and the subcontractors, and therefore no "obligation" on the Airport Authority to pay subcontractors. That is true, but not directly relevant at this stage of the analysis. The Airport Authority has no "obligation" to do any of the "Work"; it was Iona that was obliged to improve the airfield and perform all of the covenants in the contract, including paying the subcontractors. The issue at this stage is not whether the Airport Authority has an "obligation" to pay the subcontractors (or otherwise complete the Work), but whether it has the "right" to do so under clause 6.3.3(d).

[14] As the chambers judge noted at para. 21, this argument is "compelling", but it is not necessary to resolve whether, on the wording of the contract, paying the subcontractors is "something that is necessary to be done under the Contract", and therefore part of the "Work". Even if the paying of the subcontractors was authorized under clause 6.3.3(d) prior to any bankruptcy, the provisions of that clause become inoperative after bankruptcy.

[15] There is nothing objectionable about a provision in a contract allowing the owner to complete work that was not performed by a bankrupt contractor, and to deduct the amount from what was otherwise owing to the contractor. Section 97(3) of the *Bankruptcy and Insolvency Act* allows such set-offs. After a bankruptcy, however, no such clause is effective to the extent that it gives a discretion to the owner to pay creditors of the bankrupt contractor otherwise than as authorized in the *Bankruptcy and Insolvency Act*: ***A.N. Bail Co. v Gingras***, [1982] 2 SCR 475 at pp. 485-7. It is at this stage of the analysis that it is relevant that the owner has no "obligation" to pay the subcontractors, but only the "right" or "discretion" under clause 6.3.3(d). After bankruptcy, that discretion cannot be exercised in such a way that it disturbs the priorities in the *Bankruptcy and Insolvency Act.*

[16] This point was confirmed in ***Greenview (Municipal District No. 16) v Bank of Nova Scotia***, 2013 ABCA 302, 87 Alta LR (5th) 335, 556 AR 344 where the contract gave the owner municipality an explicit right to pay unpaid subcontractors:

> 1.2.35 The Contractor shall promptly pay . . . any subcontractor . . . . In the event of failure by the Contractor at any time to do so . . . the Department may retain out of any money due on any account to the Contractor from the Department such amount as the Department may deem sufficient to satisfy the same . . . . The Department may pay directly to any claimant such amount as the Department determines is owing, rendering to the Contractor the balance due after deducting the payments so made.

The Court noted at para. 41 that this clause gave the owner a wide discretion to pay any unpaid subcontractors. However, once a bankruptcy intervened, this discretion could no longer be exercised:

> . . . once bankruptcy occurs any monies owing become the property of the Trustee, and the terms of the contract do not replace the terms of the *BIA* to prefer some of Horizon's creditors over others. Once Horizon was placed in bankruptcy, all creditors stand on an equal footing vis-à-vis Horizon, and claims must be submitted in accordance with the provisions of the *BIA* section 69.3. Further, clause 1.2.35 embodies a discretion, not a commitment, on the part of Greenview, the exercise of which would reduce what Greenview might owe to Horizon either for work already billed or work to be billed.

As this passage notes, if the owner had an obligation to pay the subcontractors, and not just a discretion, the result would be different.

[17] The appellant argues that even if the Airport Authority merely had a discretion (and not an "obligation") to pay subcontractors under the contract, it does have such an obligation under the Labour and Material Payment Bond. The appellant argues that when the construction contract and the bond are read together, they disclose an obligation on the part of the Airport Authority to "mitigate" the exposure of the surety, which includes using the holdback funds to pay the subcontractors. Even if the agreements, when read together, disclose some intention to minimize the exposure of the surety, the private arrangements between the owner, the contractor, and the bonding company cannot affect the rights of third parties like the Trustee in bankruptcy and the secured creditor. Whatever rights the appellant may have were not registered at the Personal Property Registry, and cannot displace the rights of the secured party. Further, in ***Greenview*** the Court confirmed that the existence of a surety and a bonding arrangement did not change the outcome.

[18] It follows that the appellant is unable to succeed based on its argument that no money was due to Iona under the contract.

The Trust Argument

[19] In the alternative, Guarantee Company argues that it is entitled to the disputed funds by virtue of the trust created by s. 22 of the *Builders' Lien Act*. It argues that the unpaid subcontractors are the beneficiaries of that trust, and that it is subrogated to their position. The Trustee replies that the trust created is inconsistent with the priorities set by the *Bankruptcy and Insolvency Act*, and so cannot assist Guarantee Company.

The Builders' Lien Act

[20] The general provisions of the *Builders' Lien Act* are well known. At common law, subcontractors have no claim against the owner of property that they improve, because there is no privity of contract between them. The *Builders' Lien Act* provides a partial remedy to that problem. It allows an unpaid subcontractor to file a lien against the owner's property, and potentially to sell the owner's property to satisfy its claim. The owner can post security in substitution for the lien, in which case the subcontractor's rights are transferred to the security. The owner can also limit its exposure by keeping statutorily mandated "holdbacks", which it can decline to pay to the contractor until it is satisfied that there are no liens. If necessary, the owner can pay the holdback into court, and allow the contractor and the subcontractors to litigate entitlement.

[21] The *Builders' Lien Act* therefore creates a comprehensive, integrated system that provides some assurance to subcontractors that they will get paid for improving land. A portion of that overall regime is a statutory trust found in s. 22:

> 22(1) Where
>
> (a) a certificate of substantial performance is issued, and
>
> (b) a payment is made by the owner after a certificate of substantial performance is issued
>
> the person who receives the payment, to the extent that the person owes money to persons who provided work or furnished materials for the work or materials in respect of which the certificate was issued, holds that money in trust for the benefit of those persons.
>
> (2) When a person other than a person who received the payment referred to in subsection (1)
>
> (a) is entitled to the money held in trust under this section, and
>
> (b) receives payment pursuant to that trust,
>
> the person, to the extent that the person owes money to other persons who provided work or furnished materials for the work or materials in respect of which the

> payment referred to in clause (b) was made, holds that money in trust for the benefit of those other persons.
>
> (3) A person who is subject to the obligations of a trust established under this section is released from any obligations of the trust when that person pays the money to
>
> (a) the person for whom that person holds the money in trust, or
>
> (b) another person for the purposes of having it paid to the person for whom the money is held in trust.

Neither the trust provisions, nor any other portion of the *Builders' Lien* statutory regime should be read in isolation. They are all a part of one comprehensive package relating to property and civil rights in the province.

[22] These trust provisions are narrow in their operation. They only apply when "a certificate of substantial performance is issued", as occurred here. That certificate is a precondition to the release of the holdback funds under s. 21, which to that point have been held by the owner to ensure that the subcontractors will be paid, and to satisfy the owner's obligation should a lien be filed. Section 22 ensures that when the remaining funds are paid out, they will end up in the hands of any unpaid subcontractors. Section 22 effectively uses the mechanism of a trust to avoid the diversion of the holdback funds, after the issue of the certificate of substantial completion, but before the funds actually reach the unpaid subcontractors. If, in this situation, the $997,716 had been paid by the Airport Authority to Iona or the Trustee, under the statute the recipient would have held the funds in trust for the subcontractors.

[23] It is obvious that the *Builders' Lien Act* could have an effect on the entitlement to payments on bankruptcy. A subcontractor which has a valid lien, or another valid claim under the *Builders' Lien Act,* might become entitled to a payment to which it would not be entitled as a mere unsecured creditor. No one has suggested that these provisions, relating as they do to property and civil rights in the province, necessarily offend the bankruptcy distribution regime.

[24] An added complication in this appeal is that airport lands fall under federal jurisdiction, and so cannot be liened. This is primarily because it would be incompatible with the regulation of airports to permit any portion of the airport lands to be sold to satisfy the liens. In this case, the parties agree that the trust provisions in s. 22 can nevertheless apply, and the appeal was argued on that basis: see ***Minneapolis-Honeywell Regulator Co. v Empire Brass Manufacturing Co.***, [1955] SCR 694; ***Canadian Bank of Commerce v T. McAvity & Sons Ltd.***, [1959] SCR 478; ***Kerr Interior Systems Ltd. v Kenroc Building Materials Co. Ltd.***, 2009 ABCA 240 at paras. 14, 17, 6 Alta LR (5th) 279, 457 AR 274. The trust provisions should not, however, be interpreted as if they were a "stand alone" trust; they are still a part of the overall scheme in the *Builders' Lien Act.*

The Bankruptcy and Insolvency Act

[25] The *Bankruptcy and Insolvency Act* is federal legislation, the general provisions of which are also well known. It governs the orderly distribution of the estates of bankrupt persons, and in particular specifies the priority in which competing claims will be paid. Provisions like s. 72 confirm that the *Bankruptcy and Insolvency Act* operates against the background of property and civil rights created by provincial law. In the event of an operational conflict, the federal provisions prevail.

[26] The *Bankruptcy and Insolvency Act* incorporates numerous provisions that determine the priority of payments to claimants in a bankruptcy. In the most general terms, the scheme is:

> (a) Under s. 67(1), only "property of the bankrupt" is available for distribution to any class of claimants. Under s. 67(1)(a) property "held by the bankrupt in trust for any other person" is not considered to be property of the bankrupt, and so is not available to the creditors of the bankrupt.
>
> (b) Under s. 136(1), the scheme of distribution is made "subject to the rights of secured parties". Secured parties are thus entitled to enforce their security in accordance with provincial law, without regard to the scheme in the *Bankruptcy and Insolvency Act.*
>
> (c) Section 136 next lists, in order of priority between themselves, a dozen categories of claims that have priority over general unsecured claims. Priority is given to things like funeral expenses, costs of administration, some wage claims, etc.
>
> (d) Finally, s. 141 provides that all other claims will be payable rateably, subject to a few specific statutory exceptions.

The categorization of a claim for the purposes of relative priority is a matter of federal law. Thus, the provinces cannot define what is a "trust" or a "secured party" for the purposes of bankruptcy law; which claims are included in those various categories is a matter of federal law. This ensures the uniformity of bankruptcy law across Canada. But while uniformity of bankruptcy law is an important value, that does not mean that results will not vary from province to province. Since "property and civil rights" can vary depending on provincial law, a type of creditor in one province may be in a different position after bankruptcy than the same type of creditor in another province.

Interaction of the Federal and Provincial Law

[27] Because federal bankruptcy legislation is enacted against the background of provincial laws respecting property and civil rights, there will be occasions when a different outcome will result depending on which law is applied. As mentioned, in case of operational conflict federal law prevails. Obviously a deliberate attempt by a province to change the order of priority in bankruptcy will be ineffective, but an operational conflict can arise short of that.

[28] There have been a number of cases in which operational conflicts have arisen:

(a) In ***Quebec (Deputy Minister of Revenue) v Bourgault (Trustee of)***, [1980] 1 SCR 35 the provincial statute purported to create a priority for unpaid sales tax debts owed to the province, by deeming them to be a privileged debt. The relative priority for such claims was specifically dealt with in what is now s. 136(1)(j), which applied "notwithstanding any statutory preference to the contrary". This provincial attempt to create a new category of "privileged creditor" created an operational conflict with federal legislation, and was ineffective.

(b) In ***Deloitte Haskins and Sells Ltd. v Alberta (Workers' Compensation Board)***, [1985] 1 SCR 785 the provincial statute purported to create a charge on all of the property of the employer, thereby making the Board a secured creditor. The priority for Workers' Compensation Board claims was specifically dealt with in what is now s. 136(1)(h), and this attempt to create a secured claim was also ineffective.

(c) ***Federal Business Development Bank v Québec (Commission de la santé et de la sécurité du travail du Québec)***, [1988] 1 SCR 1061 was another attempt to turn a workers' compensation claim into a secured claim. This provision was also held to be ineffective, even if the enforcement of the secured claim took place outside the bankruptcy regime.

(d) The provincial statute in ***British Columbia v Henfrey Samson Belair Ltd.***, [1989] 2 SCR 24 attempted to create a priority for unpaid sales taxes. Rather than deeming the Crown's claim to be "secured", this legislation deemed a "trust" in support of the unpaid claim, in an attempt to withdraw the assets from the bankruptcy regime under s. 67(1)(a). This "trust" was held not to be a true trust for bankruptcy purposes, and the priority of the claim was governed by what is now s. 136(1)(j). While the provinces could define "trust" for purposes of provincial legislation, only the common law definition of a "trust" met the requirements for a trust under federal bankruptcy law.

(e) In ***Husky Oil Operations Ltd. v Canada (Minister of National Revenue)***, [1995] 3 SCR 453 the provincial statute did not purport to create either a secured claim or a trust. Rather it deemed the debtor of the bankrupt to be the surety or guarantor of the bankrupt's obligations to the Worker's Compensation Board. If the bankrupt did not pay the Board, the debtor had to pay, but it could then set off what it had paid against its debt owing to the bankrupt. The effect of the regime was to divert funds from the bankrupt's estate to pay the Board. This statutory technique was also held to create an operational conflict.

Some of these challenged provisions affected the payment priorities set out in the *Bankruptcy and Insolvency Act* more directly than the ones involved in this appeal. A feature of most of them was that they purported to create interests with priority that attached to all the assets of the bankrupt, not just to any discrete asset: see ***Henfrey Samson Belair*** at pp. 33-4.

[29] In ***Husky Oil*** the Court set out certain principles for evaluating the effectiveness of provincial legislation after bankruptcy. It rejected two possible rules:

> (a) First, it rejected (at para. 31) the "broader 'bottom line' approach", which postulated that any provincial law that affects the final result in bankruptcy would create an operational conflict. Such a broad rule was inconsistent with the accepted premise that property and civil rights were defined, in many fundamental ways, by provincial legislation.
>
> (b) The Court also rejected (at para. 32) the "narrower 'jump the queue' approach", by which an operational conflict would only arise if there were a manifest intention to change priorities in bankruptcy. The scope of operational conflict was wider than this approach.

In the result, the Court endorsed a position between these extremes.

[30] ***Husky Oil*** sets out (at paras. 33, 40) six propositions underlying the proper approach:

> (1) provinces cannot create priorities between creditors or change the scheme of distribution on bankruptcy under s. 136(1) of the *Bankruptcy Act*;
>
> (2) while provincial legislation may validly affect priorities in a non-bankruptcy situation, once bankruptcy has occurred section 136(1) of the *Bankruptcy Act* determines the status and priority of the claims specifically dealt with in that section;
>
> (3) if the provinces could create their own priorities or affect priorities under the *Bankruptcy Act* this would invite a different scheme of distribution on bankruptcy from province to province, an unacceptable situation;
>
> (4) the definition of terms such as "secured creditor", if defined under the *Bankruptcy Act*, must be interpreted in bankruptcy cases as defined by the federal Parliament, not the provincial legislatures. Provinces cannot affect how such terms are defined for purposes of the *Bankruptcy Act*.
>
> (5) in determining the relationship between provincial legislation and the *Bankruptcy Act*, the form of the provincial interest created must not be allowed to triumph over its substance. The provinces are not entitled to do indirectly what they are prohibited from doing directly;
>
> (6) there need not be any provincial intention to intrude into the exclusive federal sphere of bankruptcy and to conflict with the order of priorities of the *Bankruptcy Act* in order to render the provincial law inapplicable. It is sufficient that the effect of provincial legislation is to do so.

These propositions, unfortunately, do not establish where the line is between effective and inoperative provincial legislation. Many of them merely confirm that the terms and concepts used in the *Bankruptcy and Insolvency Act* must be determined by federal law, which prevails over provincial law. The first proposition, in particular, cannot be read as endorsing the explicitly rejected "broader 'bottom line' approach". Whether any provincial scheme is in operational conflict with the bankruptcy regime must be determined by examining the purposes and effect of the provincial legislation within its statutory context.

[31] Because ***Husky Oil*** rejected the "broader 'bottom line' approach", it is not sufficient to note that the impugned provincial legislation has some effect on priorities. It is only where provincial law interacts with federal bankruptcy law (i.e., somebody is insolvent) that the issue even arises. Obviously, if everyone is solvent, nobody cares about trusts, secured interests or priorities. If everyone is solvent, nobody cares about builders' liens either. Whether anybody has a secured or prior claim depends on provincial law over property and civil rights, so in one sense all priorities are set by provincial law. Merely noting that a provincial law has some effect on priorities is not determinative.

The Operational Validity of the Builders' Lien Act

[32] On what side of the line do the trust provisions in s. 22 of the *Builders' Lien Act* stand?

[33] An important consideration is that these trust provisions do not directly, intentionally, or primarily affect the order of payment in bankruptcy. They are part of a larger statutory scheme designed to create new civil rights for unpaid subcontractors. The holdback provisions and the trust provisions play a supportive role in the overall regime, and are primarily in place to prevent the unjustified erosion of the lien rights created by the statute. There is no attempt to use "form to override substance"; the trust is a legitimate part of the overall scheme. However, ***Husky Oil*** confirms that an intention to reorder priorities is not necessary to create an operational conflict.

[34] ***Henfrey Samson Belair*** at pp. 34-5 confirms that the definition of "trust" encompasses, at least, all common law trusts. The common law test for a trust requires three certainties: certainty of intention, certainty of objects and certainty of subject matter. In most common law trusts, the "intention" arises because (a) the settlor forms and declares an intention to hold property in trust, or (b) property is transferred to somebody with the intention that the recipient hold the property in trust. A statutory trust is imposed by law, so it is not "intentional" in that sense; for a statutory trust to meet the common law test for a trust, the general law must be applied by analogy.

[35] ***Henfrey Samson Belair*** at p. 34 concluded:

> In summary, I am of the view that s. 47(a) should be confined to trusts arising under general principles of law, while s. 107(1)(j) should be confined to claims such as tax claims not established by general law but secured "by her Majesty's personal preference" through legislation. (emphasis added)

Bassano Growers Ltd. v Diamond S. Produce Ltd. (Trustee of), 1998 ABCA 198 at para. 12, 66 Alta LR (3d) 296, 216 AR 328 interpreted ***Henfrey Samson Belair*** as accepting that some statutory trusts could qualify under the "general principles of law":

> This is not to say that a trust that meets the requirements of the general law, and therefore qualifies as a trust under s. 67(1)(a) of the BIA, may not have its genesis in a deemed or statutory trust. It must, however, satisfy the essential requirements of a valid trust under the general law in order to do so. Here, the purported trust fails to meet the necessity for certainty of subject-matter. (emphasis added)

The alternative interpretation of ***Henfrey Samson Belair*** would be that no statutory trust could ever qualify as a trust "arising under general principles of law", if only because statutory trusts are in one sense "involuntary". That alternative interpretation is, however, inconsistent with the specific findings in ***Henfrey Samson Belair*** at p. 34 about the statutory trust that was the subject of that decision:

> . . . At the moment of collection of the tax, there is a deemed statutory trust. At that moment the trust property is identifiable and the trust meets the requirements for a trust under the principles of trust law. The difficulty in this, as in most cases, is that the trust property soon ceases to be identifiable. The tax money is mingled with other money in the hands of the merchant and converted to other property so that it cannot be traced. At this point it is no longer a trust under general principles of law. . . . There is no property which can be regarded as being impressed with a trust. Because of this, s. 18(2) goes on to provide that the unpaid tax forms a lien and charge on the entire assets of the collector, an interest in the nature of a secured debt. (emphasis added)

The problem with the trust in ***Henfrey Samson Belair*** was that there was no certainty of subject matter, not that a statutory trust could never qualify as a "trust arising under general principles of law".

[36] In most statutory trust situations, only the third certainty will be in play. Certainty of intention and certainty of objects will usually be satisfied by the terms of the statute. If the statute uses the word "trust", the intention is clear: ***Re: 0409725 B.C. Ltd***., 2015 BCSC 561 at para. 22. Usually the intended beneficiary of the trust will also be obvious. The only potential for uncertainty is over the assets that are covered by the trust.

[37] The trusts created by s. 22 meet the requirements of the general principles of trust law:

(a) There is certainty of intention. The "intention" of s. 22 is clearly to create a trust;

(b) There is certainty of object. The beneficiaries of the trust are clearly the unpaid subcontractors;

(c) There is certainty of subject matter. Section 22 provides that once a certificate of substantial completion is issued, any "payment by the owner" is subject to the trust. At this stage the owner's primarily obligation will be to pay out the holdback, and its obligation to do so represents a discrete chose in action. That chose in action is the subject matter of the trust. If, as the Trustee postulates, the Airport Authority had written a cheque for $997,716 to Iona, that bill of exchange and those funds would have been trust assets in Iona's hands.

It follows that the provisions of s. 22 meet the requirements of a common law trust. There is no deliberate attempt to reorder priorities in bankruptcy, and the province is not attempting to achieve indirectly what it cannot do directly. These considerations, coupled with the fact that the trust provisions of s. 22 are merely a collateral part of a complex regime designed to create security for unpaid subcontractors, leads to the conclusion that there is no operational conflict.

[38] One of the objections to the statutory scheme in ***Henfrey Samson Belair*** was that the trust in question did not attach to any specific funds. It purported to attach to all the assets of the bankrupt tax collector as if it were a secured claim, like a type of general floating charge. The trust in s. 22 does not suffer from this deficiency, because it only attaches to the discrete sum of money paid by the owner after the certificate of substantial completion has been issued. The other assets of the owner (the Airport Authority) and the contractor (Iona) are unaffected. There is no attempt to throw a general trust over all the assets of the bankrupt.

[39] A number of decisions touch on this issue. In ***John M.M. Troup Ltd. v Ontario (Attorney General)***, [1962] SCR 487 the Court considered the provisions of Ontario's *Mechanics' Lien Act*. That statute purported to create a trust over "all funds received by a contractor on account of the contract price", and therefore had a wider reach than the Alberta statute involved here. The contractor had one account at the Royal Bank, into which it deposited funds it received from many projects all over the province. The Bank was sued for allegedly appropriating trust funds, but on the particular facts the Court held that the Bank could not reasonably have suspected that the funds were deposited in breach of any trust, or that there were any unpaid lien claimants. In response to an alternative argument about the validity of the trust, the Court held at p. 494: "It is suggested that the legislation is in conflict with federal legislation on banking and bankruptcy but in my opinion the conflict does not exist in either field." ***Troup*** supports the appellant's proposition that the trust provisions under the *Builders Lien Act* are effective even after bankruptcy. The decision is, however, inconclusive because the statement relied on is *obiter*, and must be read in the light of the subsequent decisions, discussed *supra*, paras. 28-30.

[40] In ***Duraco Window Industries (Sask.) Ltd. v Factory Window & Door Ltd.*** (1995), 135 Sask R 235, 34 CBR (3d) 196 the bankrupt deposited all of its receipts from several projects into a single bank account. On bankruptcy, there was a balance remaining in that bank account. Since the statute in question created a trust over "all amounts owing" to a contractor or subcontractor, an unpaid supplier argued that all of these funds were impressed with a trust. The court held that there was no certainty of intention, because there was no instrument that showed an intention by the

supplier and the bankrupt to create a trust. If ***Duraco Window*** is correct, then no statutory trust will ever meet the common law test. If the wording of the statute creating a trust is not sufficient to demonstrate an intention to create a trust, no statutory trust will ever be effective, because the trustee and beneficiary are never involved at that stage. This is inconsistent with the decision in ***Henfrey Samson Belair*** which implies that some statutory trusts can be effective. The real problem with the trust created in ***Duraco Window*** is that it lacked certainty of subject matter, because it purported to throw a general trust over all of the assets of the bankrupt. It was impossible for any third party to tell which assets of the contractor were trust assets, and which were not.

[41] ***Roscoe Enterprises Ltd. v Wasscon Construction Inc.*** (1998), 169 Sask R 240, 161 DLR (4th) 725 was another decision arising out of a statutory trust over "all amounts owing" to a contractor or subcontractor. The balance of the funds owing to the bankrupt contractor had been paid into court, and the dispute was between the Trustee and the unpaid subcontractors. This decision also interpreted ***Henfrey Samson Belair*** as invalidating all statutory trusts, and followed ***Duraco Window***.

[42] In ***D&K Horizontal Drilling (1998) Ltd. (Trustee of) v Alliance Pipeline Ltd.***, 2002 SKQB 86, 216 Sask R 199, 33 CBR (4th) 217 the bankrupt contractor had substantially completed its contract at the date of its bankruptcy, leaving unpaid subcontractors. The owner paid the outstanding funds into court to vacate liens on the land. The court held at para. 23 that the liens were valid interests that could be enforced after bankruptcy, and that the funds in court were merely a substitute for that security. Accordingly, the subcontractors were entitled to the funds. It was not necessary to rely on the trust provisions in the statute, but in the alternative the court at para. 37 distinguished ***Duraco Window*** and ***Roscoe Enterprises*** on the basis that the funds in question in ***D&K*** were paid into court to discharge the liens.

[43] In ***Royal Bank of Canada v Atlas Block Co.***, 2014 ONSC 3062 at para. 36, 15 CBR (6th) 272, 37 CLR (4th) 286 it was held that "there is no apparent reason why a deemed trust under the [*Construction Lien Act*] should be treated differently than any other provincial statutory deemed trust for the purposes of para. 67(1)(a) of the *BIA*." ***Atlas Block***, like ***Duraco Window*** and ***Roscoe Enterprises***, reads the prior Supreme Court of Canada authorities as essentially holding that no statutory trust will be effective after bankruptcy. This approach, however, appears to be inconsistent with the decision in ***Husky Oil*** which specifically rejected the "broader 'bottom line' approach". If the Supreme Court believed that no statutory trust was ever effective, or that all provincial statutory trusts were indistinguishable for the purposes of bankruptcy law, it would have just said so in ***Henfrey Samson Belair***. In effect, the "broader 'bottom line' approach" would be the prevailing principle. On the contrary, the Court held at p. 34 that the statutory trust there did meet the first two requirements of a common law trust. By recognizing that there was room between the "broader 'bottom line' approach" and the "narrower 'jump the queue' approach", the Court essentially recognized that some provincial statutory trusts could be effective: ***Re: 0409725 B.C. Ltd.*** at para. 20. It is simply not enough to say that "all statutory trusts are the same".

[44] The remaining issue is whether a trust must be in effect prior to the bankruptcy, in order to be effective after the bankruptcy. There is some passing suggestion in a few cases that a trust arising after bankruptcy is ineffective, but there is no binding authority to that effect. It is certainly true that no one can create a trust after bankruptcy in an attempt to withdraw assets from the estate and reorder priorities, but that does not mean that legitimate trusts that arise or are perfected after the bankruptcy are ineffective.

[45] Section 67(1)(a) does not impose any temporal limit on when the trust arises, and only requires that the property be "held by the bankrupt in trust for any other person". Requiring that the trust exist prior to the bankruptcy might generate anomalous results. For example, had the Airport Authority written the cheque for the holdback, and mailed it to Iona, the date of receipt might be critical. If the trust must be perfected before bankruptcy, and had Iona received and deposited the cheque the day before the bankruptcy, the trust would be valid. However, if the same cheque arrived and Iona deposited it the day after the bankruptcy, the trust would not be valid. That does not appear to be a commercially sensible result. Another example would arise if the bankrupt became a testamentary trustee of an estate as a result of a death or other event that occurred after the bankruptcy. Yet another example would be of a bankrupt lawyer who came into possession of trust property after his or her bankruptcy. There is no reason in principle why such trust assets should accrue to the benefit of the unsecured creditors of the bankrupt, rather than the intended beneficiaries of the trust.

[46] There is also uncertainty about the concept of the trust "existing" on the date of bankruptcy. It could mean simply that on the date of bankruptcy the trust instrument existed, or the class of beneficiaries existed, or that the trust property had come into existence and was identifiable, or some combination of those. In this case the "trust" clearly existed before Iona's bankruptcy, in the sense that the provisions of the *Builders Lien Act* were in place well before its bankruptcy. The disputed funds were "held back" in accordance with the legislation before Iona's bankruptcy. They were also "payable" before its bankruptcy. The only sense in which the trust did not "exist" on the date of bankruptcy is that the Airport Authority had not yet drawn the cheque to pay the holdback funds, nor had the deemed trustee received those funds. As noted, *supra* para. 22, the trust under the statute attaches to the holdback funds themselves when they are paid out.

[47] It can be accepted that a trust cannot be created after bankruptcy if its intent or effect is to defeat the order of priorities under the *Bankruptcy and Insolvency Act*. The trusts under the *Builders' Lien Act*, however, have none of those attributes. The lien rights arise the minute the work is done, and the funds which are captured by the trust were quantified in the hands of the Airport Authority on the date of bankruptcy: ***Andrea Schmidt Construction Ltd. v Glatt*** (1979), 25 OR (2d) 567 at para. 12, 104 DLR (3d) 130 affm'd (1980), 28 OR (2d) 672, 112 DLR (3d) 371 (CA). Nothing in this case about the timing of the formation of the trust or the bankruptcy would render the statutory trust invalid or inoperative.

Involvement of the Surety

[48] In this case the subcontractors were not paid directly by Iona or the Airport. They were in fact paid by Guaranty Company under the Payment Bond. The intervention of the surety does not change the analysis, since the surety is subrogated to the rights of the unpaid subcontractors: ***E C & M Electric Ltd. v Medicine Hat General & Auxiliary Hospital & Nursing Home District No. 69*** (1987), 76 AR 281, 50 Alta LR (2d) 48. Once the appellant surety paid the subcontractors, it became entitled to enforce all of their rights under the *Builders' Lien Act*. The funds in question which were held by the Airport Authority are still intact, and available to discharge the trust. Those funds should now be paid to Guarantee Company.

Conclusion

[49] In conclusion, the disputed holdback funds are impressed by a trust under the *Builders Lien Act*, and are therefore not property of the bankrupt. The appeal is allowed, and the disputed funds should be paid to the appellant.

Appeal heard on April 8, 2015

Reasons filed at Calgary, Alberta
this 16th day of July, 2015

Slatter J.A.

I concur: Authorized to sign for: Yamauchi J.

Dissenting Reasons for Judgment Reserved
of the Honourable Madam Justice Paperny

Introduction

[50] I would dismiss the appeal. For the reasons that follow, I agree with the disposition of my colleagues on the first issue. However, I respectfully disagree with their conclusion on the standard of review, and with their analysis and conclusion regarding the existence of a common law trust in these circumstances.

Background

[51] The Calgary Airport Authority (Airport) and Iona Contractors Ltd. (Iona) entered into a contract in 2009 for the construction of improvements on the Airport's north airfield (the Contract). By October 2010, work under the Contract was substantially complete and Iona applied to receive payment. The Airport, however, had received notice that some of Iona's subcontractors remained unpaid, and withheld further payment.

[52] In December 2010, Iona applied in Ontario for protection under the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36. Iona was assigned into bankruptcy on March 18, 2011, and Ernst & Young Inc. was appointed Trustee.

[53] As a pre-condition to the Contract, the Airport required Iona to deliver a Performance Bond to guarantee the completion of the project, and a Labour and Material Payment Bond (Payment Bond) to guarantee that suppliers of materials and labour to the project would be paid. The appellant Guarantee Company of North America (GCNA) is surety with respect to both bonds.

[54] The Airport called on GCNA, as surety under the Payment Bond, to pay the outstanding accounts of Iona's subcontractors. GCNA paid out $1.48 million to subcontractors.

[55] The Airport had retained just over $1.1 million in holdback funds from Iona at the time of substantial completion. It used $105,000 to complete deficiencies remaining in the contract work, leaving $997,715.83 still in the Airport's hands (the Funds).

[56] The Trustee takes the position that the Funds are owed to Iona under the Contract and therefore should be paid to it as Trustee of Iona. The Trustee proposes to forward the Funds to Alberta Treasury Branches, Iona's secured lender.

[57] GCNA argues that it is entitled to the Funds as subrogee to the Airport. Its argument is twofold. First, GCNA argues that, because Iona breached the terms of the Contract, the Airport is

entitled to withhold payment of the Funds. Accordingly, the Funds are not a debt payable to Iona and do not form part of Iona's estate on the bankruptcy. Instead, the Funds should be paid to GCNA, as subrogee to the Airport.

[58] Alternatively, if the Funds are due to Iona, they are impressed with a trust pursuant to the trust provisions of s 22 of the Alberta *Builders' Lien Act*, RSA 2000, c B-7 (*BLA*), and therefore do not form part of the bankrupt's estate by virtue of s 67 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 *(Bankruptcy Act)*.

[59] The chambers judge considered and dismissed both of these arguments. GCNA appeals.

Issues on Appeal

[60] GCNA argues the same two issues on the appeal:

1. Are the Funds a debt payable to Iona?

2. If the Funds are payable to Iona, are they impressed with a trust such that they are exempted from the bankrupt's property pursuant to s 67 of the *Bankruptcy Act*?

Standard of Review

[61] The Supreme Court has recently clarified that "[c]ontractual interpretation involves issues of mixed fact and law as it is an exercise in which the principles of contractual interpretation are applied to the words of the written contract, considered in light of the factual matrix": ***Creston Moly Corp. v Sattva Capital Corp.***, 2014 SCC 53 at para 50. Accordingly, the chambers judge's interpretation of the contractual documents at issue here is entitled to deference. I agree with my colleagues, however, that the impact of the *Bankruptcy Act* on the effect of the contract is a question of law to which the correctness standard applies.

[62] Likewise, the interaction of the *Bankruptcy Act* and the *BLA* raises questions of law. The chambers judge's characterization of whether the circumstances here give rise to a "trust" for purposes of s 67 of the *Bankruptcy Act* is a matter of mixed fact and law, and also entitled to deference absent palpable and overriding error or an extricable error of law.

Analysis

1. Are the Funds a debt payable to Iona under the Contract?

[63] GCNA argues that the Funds are not a debt payable to Iona and therefore do not form part of Iona's estate. The chambers judge disagreed, finding that the balance of the Funds (after deducting that portion paid by the Airport and GCNA to complete the project) is payable to Iona under the Contract. She ordered that net amount, $919,846.83, be paid to the Trustee.

[64] GCNA makes several arguments based on the language of the Contract and the Payment Bond and on the general law of surety. They all lead to this: that the Airport is required to mitigate the surety's loss in making payments of some $1.48 million to subcontractors under the Payment Bond. Iona is not entitled to payment under the Contract to the extent that it has failed to meet its obligation to pay its subcontractors and suppliers. Accordingly, the remaining funds should be paid to GCNA, not to the Trustee.

[65] There are several relevant provisions in the Contract between Iona and the Airport, all of which were reviewed by the chambers judge.

[66] Under the Contract, the Airport has no duty to pay Iona's subcontractors and no contractual relationship with them: GC 1.4.1. Iona, as contractor, is required to enter into agreement with subcontractors and suppliers, and is further obliged to pay its subcontractors at least as often as the Airport is obliged to pay Iona: GC 3.12.1 and 13.1.1. Iona is also required to provide statutory declarations to the Airport regarding the status of any obligations or claims by subcontractors or otherwise arising under the Contract: GC 13.1.2.

[67] The Contract also deals with the situation where Iona becomes insolvent or commits an act of bankruptcy. In such circumstances, the Airport may take any part of the Work[1] out of the Contractor's hands (GC 6.3.1), and may then "employ such means as it sees fit to have the Work completed at the Contractor's cost and expense" (GC 6.3.2). The obligation of the Airport to make further payments to the Contractor in this situation is set out in GC 6.3.3(d):

> 6.3.3(d) the Contractor's right to any further payment that is due or accruing due (including any holdback or progress claim) for the Work taken out of the Contractor's hands is extinguished, *save and except that portion (if any) which is not required by the Airport Authority to have the Work completed or to compensate it for any consequential damages or losses arising out of the taking of the Work or any part of it out of the Contractor's hands.*
>
> [emphasis added]

[68] GC 13.7.1 gives the Airport the right to set-off costs incurred to complete the Work against any amount payable to Iona:

> 13.7.1 In addition to any right of set-off or deduction given or implied by law or the Contract, the Airport Authority may at any time set-off against any amount payable to the Contractor any amount payable by the Contractor to the Airport Authority either under the Contract or any other contract between the Contractor and the

[1] "Work" is defined as "the total construction and related services required by the Contract to be performed and Products to be supplied under the Contract, and includes everything that is necessary to be done, furnished or delivered by the Contractor to perform the Contract."

> Airport Authority under which the Contractor has an undischarged obligation to perform or supply work, labor or material or under which the Airport Authority has exercised its rights to take work out of the Contractor's hands.

[69] The Contract contemplates that the Airport was entitled to complete the Work at Iona's expense. It did so, in the amount of $105,000. The chambers judge also permitted the set-off of an additional $77,869, paid by GCNA on behalf of the Airport, for work necessary to complete the project. The Airport is expressly entitled to retain those amounts from any payments due to Iona under the Contract. What the Contract does not say is that the Airport is obliged to pay Iona's subcontractors (to the contrary, the Contract expressly places that obligation solely on Iona). Nor does it say that the Airport is entitled to pay the subcontractors and retain that amount from contractual payments otherwise due to Iona. As the chambers judge pointed out, the Contract could have provided for that course of action, but it does not.

[70] GCNA argues that Iona's breach of contract entitled the Airport to withhold <u>all</u> further payment. It says that Iona failed to satisfy its obligations under the Contract by failing to, *inter alia*, pay its subcontractors pursuant to GC 3.12.1 and provide the statutory declaration required pursuant to GC 13.1.2. It argues that payment of those subcontractors was part of Iona's responsibilities under GC 13.1.1, and so falls under the definition of "Work" in GC 1.1.54 because it was "necessary to be done ... by the Contractor to perform the Contract". When Iona did not pay, the Airport had the right (although not the obligation) to take that Work "out of the Contractor's hands" under GC 6.3.3(d) and pay the subcontractors. The funds so used were necessary to "have the Work completed", and so are not due to Iona.

[71] The chambers judge considered and rejected that argument, stating [at para 21]:

> Although GCNA's argument is compelling that Iona should not be allowed payment for its subcontractors when the Airport knows that Iona will not be able to fulfill its obligations to pay the subcontractors with these funds, the Contract does not support that this breach on the part of Iona would allow the Airport to withhold all payment as suggested by GCNA.

[72] The chambers judge concluded that GC 6.3.3(d) deals with the remedy for this breach. That provision does not say that <u>all</u> right to payment is extinguished. Rather, "that portion" of the payment that is not required by the Airport to finish the Work remains payable to Iona. She further noted that the Contract expressly allows the Airport to completely suspend payments for failure to pay certain other obligations, such as WCB and insurance: GC 9.22 and GC 10.1.7.

[73] GCNA argues further that the chambers judge's interpretation of the Contract is incomplete because she failed to read the Payment Bond and the Contract together. The Payment Bond provides that the Airport is a trustee for every Claimant under the Payment Bond (the subcontractors) and states, in part:

> The Principal [Iona] and the Surety [GCNA], hereby jointly and severally agree with the Obligee [Airport], as Trustee, that every Claimant who has not been provided for under the terms of its contract with the Principal, before the expiration of a period of ninety (90) days after the date on which the last of such Claimant's work or labour was done or performed of materials were furnished by such Claimant, may as a beneficiary of the trust herein provided for, sue on this Bond, prosecute the suit to final judgment for such sum or sums as may be justly due to such Claimant under the terms of its contract with the Principal and have execution thereon ...

[74] The purpose of the trust language in the Payment Bond is to give the Claimants, though they are not party to the Payment Bond, the right to sue the surety under the Bond directly for payment of monies owing to them by the principal (Iona, in this case): see ***Citadel General Assurance Co. v Johns-Manville Canada Inc.***, [1983] 1 SCR 513; Donovan W M Waters, ed, *Waters' Law of Trusts in Canada*, 4th ed, at 3.IV(e).

[75] The right of subrogation vis-à-vis the Claimants gives the surety the right to sue Iona on the contracts between Iona and the subcontractors. GCNA argues that the relationship among the parties under the Payment Bond also obliges the Airport, as a beneficiary under the Bond, to mitigate the surety's loss when it is required to make good the obligations of Iona under the subcontracts. The Airport, according to this theory, is required to exercise its rights and remedies against Iona under the Contract to mitigate any claims under the Bonds. In other words, the Airport must exercise its set-off rights against Iona to recover the funds paid out by GCNA.

[76] The difficulty with this argument is that nothing in the Contract or Payment Bond imposes an obligation on the Airport to pay the subcontractors directly. In the absence of a positive contractual obligation to pay subcontractors, Canadian authority makes clear that an owner cannot make such payments in the face of a contractor's bankruptcy, even if the contract gives it the option to do so: ***A.N. Bail Co. v Gingras***, [1982] 2 SCR 475.

[77] In ***A.N. Bail***, a construction contract granted the following rights to the owner, the Crown:

> 21 (1) Her Majesty may, in order to discharge lawful obligations of and satisfy lawful claims against the Contractor or subcontractor arising out of the execution of the work, pay any amount which is due and payable to the Contractor ... directly to the obligees of and the claimants against the Contractor or the subcontractor.
>
> (2) A payment made pursuant to subsection (1) is to the extent of the payment a discharge of Her Majesty's liability under the contract to the Contractor.

[78] The appellant contractor entered into a subcontract for masonry work with a company that subsequently became bankrupt. The subcontract incorporated the terms of Clause 21, set out

above. At the insistence of the Crown department, the contractor paid a supplier of the bankrupt directly, rather than paying the amount owing to the bankrupt's trustee.

[79] The question, as characterized by Chouinard J writing for the court, was "whether the contractual clause relied on can be applicable after the bankruptcy of the sub-contractor". In other words, could the owner (or the contractor), notwithstanding the intervening bankruptcy, rely on Clause 21 to make payment directly to a subcontractor or a supplier of materials, or must payment be made to the trustee of the bankrupt. The court noted that Clause 21 contains "only an option which the owner reserved in the principal contract, and appellant in its sub-contract: no obligation has been created": para 30.

[80] After considering several authorities, the Supreme Court concluded that, given the intervening bankruptcy, it was not open to the owner to pay the supplier directly and in preference to the trustee. Chouinard J said, at paras 40-42:

> [40] From the date of the bankruptcy also, the debt of [the subcontractor] against appellant passed into the hands of the trustee as part of the property of the bankrupt company, and only the trustee can obtain payment of it. ...
>
> [41] **It would be to disregard the *Bankruptcy Act* and deprive it of all meaning if the debtor of a bankrupt, instead of paying the trustee, were authorized, by contract or some other means, to pay one or other of the creditors of the bankrupt as he saw fit.**
>
> [42] I adopt the conclusion of Montgomery JA, speaking for the Court of Appeal:
>
>> The above clause of the general conditions may be perfectly valid and effective where there is no question of bankruptcy. I cannot, however, agree with Appellant that it can supplant the provisions of the *Bankruptcy Act* and entitle one unsecured creditor to be paid by preference, which would almost necessarily operated to the detriment of the other unsecured creditors. I regard this as contrary to the policy of the *Bankruptcy Act*.
>
> [emphasis added]

[81] The chambers judge here properly followed and applied the decision of the Supreme Court in ***A.N. Bail***, as well as the recent decision of this Court in ***Greenview (Municipal District No. 16) v Bank of Nova Scotia (Horizon Earthworks)***, 2013 ABCA 302. The facts in ***Horizon Earthworks*** are similar to those before us. ***Horizon Earthworks*** involved a priority dispute among a municipality (owner of the road construction project), a surety and a bank over funds being held back by the municipality from an insolvent contractor. Like this case, the contractual documents in ***Horizon Earthworks*** included a Performance Bond and a Payment Bond. At the time of the contractor's default, some $774,000.00 of the contract price remained unpaid and in the hands of

the municipality. The municipality made a claim under the Performance Bond and paid $383,000.00 to complete the project. The surety paid some of the sub-contractors and suppliers under the Payment Bond, but other subcontractors remained unpaid. It was common ground that the outstanding claims vastly exceeded the disputed amount.

[82] The municipality sought a direction as to whether it could pay the subcontractors directly out of the remaining funds. It argued that the bonds created a relationship between the municipality and the subcontractors to provide for payment, and also argued that the contract, bonds and an Indemnity and Security Agreement between Horizon and the surety together created a trust relationship whereby the funds are trust funds for the benefit of the subcontractors.

[83] The surety generally supported the municipality's position, but further argued that it was entitled to funds owing to subcontractors who may claim under the bond, by way of set-off and subrogation.

[84] This Court disagreed, concluding that the contracts did not impose a legal obligation on the municipality to pay the subcontractors directly. Accordingly, if the municipality owed money to the contractor at the time of bankruptcy, that account receivable became the property of the Trustee. In this respect, the Court relied on the reasoning of the Supreme Court in ***A.N. Bail***.

[85] As noted above, the contractual relationships in ***Horizon Earthworks*** included a Payment Bond, not present in ***A.N. Bail***. This Court rejected the argument that the existence of the Bond should lead to a different result, saying at para 43:

> In our view, the contractual arrangements here do not establish a relationship sufficient to distinguish *Bail*. Although there is language in the contracts between Horizon and Western Surety relating to unpaid funds being earmarked with a trust, Greenview [the municipality] is not a party to the Bonds or the ISA, and has no legal obligations under any of those agreements to pay unpaid creditors. While the Labour and Material Payment Bond says that Greenview, as Obligee under the Bonds, can bring claims on behalf of unpaid creditors, it does not require Greenview to do so. Nothing in any document places an obligation on Greenview to pay the unpaid creditors. Thus if Greenview owes money to Horizon at bankruptcy pursuant to the Harper Creek Contract, that account receivable becomes the property of the Trustee.

[86] The reasoning in ***Horizon Earthworks*** applies here. The Funds held by the Airport are payable to Iona, and therefore to the Trustee, and not to the subcontractors. The Airport has no obligation to pay the subcontractors and no legal relationship with them.

[87] GCNA relies on American jurisprudence which, it says, stands for the proposition that a surety is subrogated to and acquires the rights of the contractor whose obligation it discharged, the subcontractors whose claims it paid, and the owner who holds the balances and retention. The

surety, GCNA argues, has a right to payment due the contractor when the surety completes the defaulted contractor's obligations. In particular, GCNA relies upon the following description of the right of subrogation in ***Pearlman v Reliance Insurance Company***, 371 US 132, pp 7-8: "... that the Government has a right to use the retained fund to pay the laborers and materialmen; that the laborers and materialmen had a right to be paid out of the fund; that the contractor, had he completed his job and paid the laborers and materialmen, would have become entitled to the fund; and the surety, having paid the laborers and materialmen, is entitled to the benefit of all these rights to the extent necessary to reimburse it".

[88] Those authorities are not persuasive given that existing Canadian authority deals with the issue. The equitable doctrine of subrogation described by the British Columbia Court of Appeal in ***Canadian Indemnity Company v British Columbia Hydro and Power Authority***, 1976 CarswellBC 1227 at para 15; [1976] BCJ No 815 (QL) (CA) (also relied upon by GCNA) is said to entitle a surety, who carries out its obligations to pay or perform what a contractor has failed to pay or perform, to the rights of the person to whom the surety was obligated. In this case, those rights would include the right to use retained funds to complete the project, as was done. The chambers judge relied on the reasoning in ***Canadian Indemnity*** to include in that amount the cost of paying an electrical subcontractor to return to finish its work, and I would not interfere with that conclusion. It is clear from this Court's decision in ***Horizon Earthworks***, however, that the surety's subrogated rights would not include repayment for fulfilling the contractor's obligation to pay the subcontractors. The Airport has no corresponding obligation to make those payments under the Contract and importantly, under the law as set out in ***Horizon Earthworks*** and ***A.N. Bail***, the Airport had no ability to use the Funds to make voluntary payments to subcontractors in priority to other creditors, in the face of Iona's bankruptcy. I also note the decision of ***St. Paul v Genereux Workshop (Bonnyville) Ltd.*** (1984), 12 DLR (4^{th}) 238 (ABCA), where this Court declined to follow the American authorities relied upon by GCNA.

[89] The remaining Funds are a debt owing to Iona under the Contract as found by the chambers judge and are, therefore, payable to the Trustee. This ground of appeal must fail.

2. Are the Funds impressed with a trust and therefore exempt from the bankrupt's estate under the *Bankruptcy Act*?

[90] As an alternative argument, GCNA submits that, if the Funds are payable to Iona under the Contract, they are impressed with a trust by virtue of s 22 of the *BLA* such that they are excluded from the property of Iona pursuant to s 67(1)(a) of the *Bankruptcy Act*.

[91] Section 67 of the *Bankruptcy Act* exempts certain property held by a bankrupt from being divided among the bankrupt's creditors. One such exemption applies to "property held by the bankrupt in trust for any other person": s 67(1)(a). The Supreme Court of Canada described the intention behind this provision [then s 47(a)] in ***British Columbia v Henfrey Samson Belair Ltd.***, [1989] 2 SCR 24 at para 38:

> Taking the words in their ordinary sense, they connote a situation where there is property which can be identified as being held in trust. That property is to be removed from other assets in the hands of the bankrupt before distribution under the *Bankruptcy Act* because, in equity, it belongs to another person. The intention of Parliament in enacting s 47(a), then, was to permit removal of property which can be specifically identified as not belonging to the bankrupt under general principles of trust law from the distribution scheme established by the *Bankruptcy Act*.

[92] Like other Canadian lien legislation, the *BLA* includes provisions that require contractors who receive monies in payment for a project subject to the *BLA* to hold those monies in trust for their subcontractors or suppliers. Section 22 of the *BLA* provides:

> 22(1) Where
>
> (a) a certificate of substantial performance is issued, and
>
> (b) a payment is made by the owner after a certificate of substantial performance is issued
>
> the person who receives the payment, to the extent that the person owes money to persons who provided work or furnished materials for the work or materials in respect of which the certificate issued, holds that money in trust for the benefit of those persons.

[93] GCNA argues that, by operation of this provision, monies paid to Iona are impressed with a trust within the meaning of s 67(1)(a) of the *Bankruptcy Act*, such that they are exempt from distribution in the bankruptcy proceedings.

[94] Given that the project in this case is an airport, a federal undertaking, a preliminary issue arises with respect to the applicability of the provincial *BLA*. The airport property cannot be subject to a builders' lien: *Construction Builders' and Mechanics' Liens in Canada*, Bristow et al, 7th ed (Toronto: Carswell, 2010) at 2.12.1-2; ***Greater Toronto Airports Authority v Mississauga (City)***, (2000), 50 OR (3d) 641 (CA); ***Vancouver International Airport v Lafarge Canada Inc.*** (2009), 82 CLR (3d) 285 (BCSC). However, the parties here agree that the trust provisions in s 22 can apply to a project even where the lien provisions of the *BLA* do not apply, citing ***Canadian Bank of Commerce v T. McAvity & Sons Ltd.***, [1959] SCR 478, 17 DLR (2d) 529. For purposes of this appeal, I am prepared to assume that s 22 of the *BLA* applies to payments made to Iona with respect to construction of the project, and to Iona's relationship with its subcontractors. I will therefore proceed to consider whether s 22 creates a trust within the meaning of the *Bankruptcy Act*.

[95] Statutory trusts are, as the name implies, creatures of statute enacted with a view to protecting the interests of the Crown or private interests that otherwise would have little

protection. The Supreme Court of Canada has had occasion to consider whether deemed statutory trusts constitute valid trusts for the purpose of the *Bankruptcy Act*. In ***Henfrey Samson Belair***, a majority of the Supreme Court held that a "deemed trust" created by provincial legislation is not, without more, a trust within the meaning of s 67 of the *Bankruptcy Act*, nor is it entitled to priority under that *Act*. The provisions of s 67 are confined to trusts arising under general principles of law. McLachlin J, writing for the majority, interpreted the relevant provision of the *Bankruptcy Act* as follows (at para 42):

> To interpret s 47(a) [now s 67(a)] as applying not only to trusts as defined by the general law, but to statutory trusts created by provinces lacking the common law attributes of trusts, would be to permit the provinces to create their own priorities under the *Bankruptcy Act* and to invite a differential scheme of distribution on bankruptcy from province to province.

[96] McLachlin J went on to state that, depending on the facts of the case, monies collected under a statutory trust might meet the requirements for a trust under the general principles of trust law [at para 46]:

> If the money collected for tax is identifiable or traceable, then the true state of affairs conforms with the ordinary meaning of "trust" and the money is exempt from distribution to creditors by reason of [the current s 67(a)]. If, on the other hand, the money has been converted to other property and cannot be traced, there is no 'property held ... in trust' under [s 67(a)].

[97] In ***Husky Oil Operations Ltd. v Minister of National Revenue***, [1995] 3 SCR 453, 128 DLR (4^{th}) 1, the Supreme Court undertook a broad review of the effect of provincial legislation that may intrude into the federal sphere of bankruptcy. The majority set out a number of propositions that emerge from the court's quartet of decisions in this area, including ***Henfrey Samson Belair*** [at paras 33 and 40]:

> 1. Provinces cannot create priorities between creditors or change the scheme of distribution on bankruptcy under s 136(1) of the *Bankruptcy Act;*
>
> 2. While provincial legislation may validly affect priorities in a non-bankruptcy situation, once bankruptcy has occurred section 136(1) of the *Bankruptcy Act* determines the status and priority of the claims specifically dealt with in that section;
>
> 3. If the provinces could create their own priorities or affect priorities under the *Bankruptcy Act* this would invite a different scheme of distribution on bankruptcy from province to province, an unacceptable situation;
>
> 4. The definition of terms such as "secured creditor", if defined under the *Bankruptcy Act*, must be interpreted in bankruptcy cases as defined by the

federal Parliament, not the provincial legislatures. Provinces cannot affect how such terms are defined for purposes of the *Bankruptcy Act*;

5. In determining the relationship between provincial legislation and the *Bankruptcy Act*, the form of the provincial interest created must not be allowed to triumph over its substance. The provinces are not entitled to do indirectly what they are prohibited from doing directly;

6. There need not be any provincial intention to intrude into the exclusive federal sphere of bankruptcy and to conflict with the order of priorities of the *Bankruptcy Act* in order to render the provincial law inapplicable. It is sufficient that the *effect* of the provincial legislation is to do so.

[98] The goal, wrote Gonthier J, is to maintain a "nationally homogeneous system of bankruptcy priorities". Provincial laws can use the concept of "trust" for their own purposes, but they cannot affect bankruptcy priorities when doing so. ***Henfrey Samson Belair*** and ***Husky Oil*** provided that provincially created statutory trusts can only affect bankruptcy priorities when they also have all the attributes of trusts under the general principles of trust law, thus bringing them within the ambit of s 67(a) of the *Bankruptcy Act*. To conclude otherwise would be to permit provinces to create their own bankruptcy priorities outside the scheme, and to risk a situation of differing priorities in different jurisdictions.

[99] GCNA says that the governing authority with respect to trusts created under provincial builders' or mechanics' lien legislation is an earlier decision of the Supreme Court, ***John M.M. Troup Ltd., et al. v Royal Bank of Canada***, [1962] SCR 487, 34 DLR (2d) 556. In particular, GCNA relies on the following statement by the majority in *Troup* at para 11:

> As to bankruptcy, the creation of the trust by s. 3(1) [of the Ontario *Mechanics' Lien Act*] does affect the amount of property divisible among the creditors but so does any other trust validly created.

[100] There is a line of authority that has cited ***Troup*** for the proposition that lien legislation and the *Bankruptcy Act* are not operationally in conflict and therefore a lien act's trust provisions create a trust that falls within the exemption in s. 67(1)(a). These cases take the view that ***Troup*** and ***Henfrey Samson Belair*** are not in conflict: see, for example, ***D&K Horizontal Drilling (1998) Ltd. (Trustee of) v Alliance Pipeline Ltd.***, 2002 SKQB 86, [2002] 6 WWR 497; ***Re 0409725 BC Ltd.***, 2015 BCSC 561.

[101] In my view, the statement from ***Troup*** set out above cannot sit comfortably with the later reasoning of McLachlin J in ***Henfrey Samson Belair***. The dissent in ***Henfrey Samson Belair*** relied on ***Troup***, but the majority did not. Although ***Troup*** was not expressly overruled by the majority, McLachlin J clearly rejected the proposition that deemed statutory trusts could be valid trusts under bankruptcy legislation if they did not otherwise meet the requirements of general trust

law. To the extent that ***Troup*** says that trusts created by lien legislation, without more, are valid trusts under the *Bankruptcy Act*, it has been overruled by ***Henfrey Samson Belair***.

[102] Even if this aspect of ***Troup*** has not been overruled, the brief statement in that case regarding trusts created by lien legislation is at best *obiter*. It is important to consider what was actually at issue in ***Troup***. A contractor had received monies for work done on a county project and deposited the cheque into its current account. The contractor had previously given its bank a general assignment of book debts. The bank used the deposited funds to pay down some of the contractor's indebtedness. It was alleged that the monies which were taken by the bank under the assignment were trust monies under the *Mechanics' Lien Act*, and accordingly the bank must account to the appellant lien holders who had claims under that *Act*. A majority of the Supreme Court held that the payment received by the bank was in the ordinary course of business and a bank that received monies, not through the assignment but through the ordinary course of business, can retain such funds unless it has notice not only that they are trust monies but also that the payment to the bank constitutes a breach of trust.

[103] One argument advanced by the bank was that the *Mechanics' Lien Act* was unconstitutional as being in conflict with federal legislation on banking and bankruptcy. The majority rejected this argument, stating that there was no conflict in either field. Importantly, there was no intervening bankruptcy on the part of the contractor, so the issue of whether there was an operational conflict between the lien legislation and the *Bankruptcy Act* was not directly before the court. The statement relied on by GCNA was made in that context and was, in my view, *obiter*.

[104] The correct approach to the question of whether a builders' lien trust is valid under the *Bankruptcy Act* is to assess the putative trust through the lens of general principles of trust law and, in particular, consider whether the three certainties (of intention, object, and subject matter) have been established. This approach is in keeping with the Supreme Court's direction in ***Henfrey Samson Belair*** and ***Husky Oil***. The issue is whether there exists a trust that survives the bankruptcy of the statutorily mandated trustee, pursuant to s 67(1)(a) of the *Bankruptcy Act*. There is no such valid trust unless it possesses all the elements of a trust under general law.

[105] This was the approach taken by this Court in ***Bassano Growers Ltd. v Diamond S. Produce Ltd. (Trustee of)***, 1998 ABCA 198. In that case, a chambers judge concluded that a deemed statutory trust in favour of potato growers who sold produce to a now bankrupt purchaser, without more, was not a "trust" within the meaning of s 67(1)(a). On the evidence, the chambers judge concluded that the existence of a trust under the general law could not be found for a lack of certainty of subject matter. In upholding that decision, this Court set out the relevant principles as follows at paras 8 – 10:

> [8] The chambers judge held that the trusts contemplated by s 67(1)(a) are only those that qualify as trusts under the general law, that is, only those that meet the conditions necessary for the creation of a valid trust under the general law. Because the funds in question were commingled and cannot be identified there is no

> certainty of subject matter, one of the essential requirements for a common law trust. ...
>
> [9] The circumstances of this case fall squarely within the rationale of the majority judgment of the Supreme Court of Canada in ... *Henfrey Samson* .... The *ratio* of *Henfrey Samson* has been applied in a number of subsequent judgments involving statutory trusts of various kinds created pursuant to provincial legislation [citations omitted].
>
> [10] The underlying principle of *Henfrey Samson* was concisely stated by the British Columbia Court of Appeal in *British Columbia v National Bank of Canada* ... at 232:
>
>> That principle being that the province cannot legislate to, in effect, create its own priorities contrary to those in the *Bankruptcy Act*. If the province cannot deem a trust in order to accomplish this I cannot see how it can by legislation create facts through that legislation to accomplish that same end.

[106] Having concluded that a valid trust had not been created in the circumstances before it, the Court went on to note that a trust that has its genesis in a deemed or statutory trust may qualify under s 67(1)(a) in the right circumstances. However, to so qualify it must "satisfy the essential requirements of a valid trust under the general law". I agree.

[107] Neither ***Henfrey Samson Belair*** nor ***Bassano*** dealt with statutory trusts created under lien legislation. The deemed statutory trust in ***Henfrey Samson Belair*** was created under the *Social Service Tax Act*, RSBC C-431, and was intended to benefit the Crown. Later decisions have concluded that the principles set out in ***Henfrey Samson Belair*** apply to other statutory trusts, regardless of the nature of the deemed beneficiary: see ***Edmonton Pipe Industry Pensions Plan Trust Fund (Trustees of) v 350914 Alberta Ltd.***, 2000 ABCA 146, 187 DLR (4th) 23 at para 41; ***Bassano***; ***British Columbia v National Bank of Canada*** (1994), 30 CBR (3d) 215 at 232 (BCCA); ***Re Points of Call Holidays Ltd.*** (1991), 54 BCLR (2d) 384 (BCSC) at 389.

[108] I see no principled reason why the approach should be different with respect to lien legislation from that taken with respect to other deemed statutory trusts, particularly those intended to benefit private parties such as was the case in this Court's decisions in ***Bassano*** and ***Edmonton Pipe***. Moreover, courts in several jurisdictions have used this same approach in assessing whether trusts created under lien legislation are valid for purposes of the *Bankruptcy Act*: see ***0409725 BC Ltd***, 2015 BCSC 561; ***Royal Bank of Canada v Atlas Block Co.***, 2014 ONSC 3062, 15 CBR (6th) 272; ***Roscoe Enterprises Ltd. v Wasscon Construction Inc.*** (1998), 161 DLR (4th) 725, 169 Sask R 240 (SKQB); ***Re Factory Window and Door Ltd. (Duraco Window)***, [1995] 9 WWR 498, 135 Sask R 235 (SKQB). In all those cases, courts have examined the facts to assess whether the three certainties required to establish a valid trust under the general law are present.

[109] Most courts dealing with deemed statutory trusts seem to assume that certainty of intention has been established, perhaps implied by virtue of the statutory language that creates the trust[2]. That appears to have been the case in ***Henfrey Samson Belair***, where McLachlin J does not discuss the intention to create the trust. An exception is ***Duraco Window***, where Geatros J of the Saskatchewan Court of Queen's Bench expressed doubt that the parties intended to create a trust relationship with respect to the funds in the bankrupt contractor's bank account. Although the issue seems not to be entirely settled, for purposes of this appeal I have accepted that the creation of the statutory trust in s 22 of the *BLA* is sufficient to establish certainty of intention.

[110] The establishment of certainty of object is also generally straightforward; in trusts created under lien legislation, the object is the subcontractors sought to be protected by the legislation.

[111] Establishing sufficient certainty of subject matter has consistently been the main stumbling block to establishing a builders' lien trust as a valid trust under the *Bankruptcy Act*. That was the problem identified by the courts in, for example, ***Henfrey Samson Belair***, ***Bassano***, and in this case in the court below. In ***0409725 BC Ltd.***, a recent case from the British Columbia Supreme Court, Grauer J noted that the issue of certainty of subject matter is an evidentiary one. That is the case; in ***Henfrey Samson Belair***, McLachlin J stated that whether there exists a "trust" under the *Bankruptcy Act* "depends on the facts of the particular case": para 46. Whether certainty of subject matter exists is dependent on the facts and is, to some extent, a function of the statutory language and a question of timing.

[112] A review of cases where certainty of subject matter has been found shows that the court was able to point to a specific, identifiable *res* that formed the subject matter of the trust, thereby satisfying the requirements of ***Henfrey Samson Belair***. For example, in ***D&K***, a registered lien had been vacated and replaced by a payment into court prior to the bankruptcy.

[113] Similarly, in ***Kerr Interior Systems Ltd. v Kenroc Building Materials Co. Ltd.***, 2009 ABCA 240, [2009] 8 WWR 1, an owner paid money into court in order to vacate builders' liens filed by two subcontractors of the bankrupt. The Saskatchewan *Builders' Lien Act* was at issue in that case, which was decided by this Court. The majority found that, on the facts, both claimants were able to establish claims to amounts that were "readily ascertainable and identifiable" as at the relevant date. The dissenting judge held that in order to constitute a "trust" for purposes of the CCAA, the claim had to be sufficiently specific as at the relevant date in order to reach the position of a trust at law. One of the claimants had filed a lien under the Saskatchewan *BLA*, thereby making its claim sufficiently ascertainable. The other had not, and that trust claim was not sufficiently specific as of the relevant date.

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[2] For a discussion of certainty of intention in this context, see Aline Grenon, "Common law and statutory trusts: In search of missing links" (1995) 15:2 Est & Tr J.

[114] It is also worth noting that the Saskatchewan *Builders' Lien Act* is structured differently from the Alberta *BLA*. The owner, as well as the contractor, is made a trustee over all amounts in the owner's hands that are payable to the contractor. Under s 22 of the Alberta *BLA*, no trust comes into existence until payment is made to the contractor, who is the sole trustee. In this case, the funds were in the hands of the Airport at the time of the bankruptcy (and are still), so no *BLA* trust had come into existence.

[115] In cases where the requisite certainty of subject matter has been absent, it is often because funds from all sources flow into the putative trustee's account, resulting in commingling and an inability to trace the funds that are subject to the trust. In ***Atlas Block***, Penny J noted that the bankrupt contractor was under no obligation under the provisions of the relevant lien legislation to keep the putative trust funds separate and apart from other funds received. Because the funds were commingled with funds from other sources, there could be no certainty of subject matter as described in ***Henfrey Samson Belair***: paras 43 – 45. Similar reasoning was applied by the courts in ***0409725 BC Ltd***, ***Roscoe Enterprises***, and ***Duraco Window***.

[116] This is one of the latter cases. The chambers judge reviewed the evidence and submissions of counsel and concluded that, once the funds in the hands of the Airport were paid to Iona they would be immediately commingled with funds from other sources and any certainty of subject matter lost. That conclusion is supported by the language of s 22 of the *BLA*, which does not obligate a contractor who receives payment to segregate the funds. The same type of commingling was found to be fatal to the existence of a valid trust in ***Bassano*** and in ***Henfrey Samson Belair***, both cases that were binding on the chambers judge. There is no basis to interfere with her conclusion on the point.

[117] For these reasons, I would dismiss the second ground of appeal.

Conclusion

[118] For all the foregoing reasons, I would dismiss the appeal.

Appeal heard on April 8, 2015

Reasons filed at Calgary, Alberta
this 16th day of July, 2015

Paperny J.A.

Appearances:

H.A. Gorman, Q.C.
S. Jenkins (student-at-law)
for the Respondent

R.H. Shaban
J.W. MacLellan
for the Appellant

TAB 3

Court File #33234/88
Date: 20020916

SUPERIOR COURT OF ONTARIO

B E T W E E N	
MORRIS WAXMAN and MORRISTON INVESTMENTS LIMITED Plaintiffs	***Robert S. Harrison*** and ***Richard B. Swan*** for the Plaintiffs
-and-	
CHESTER WAXMAN, CHESTER WAXMAN, in trust, CHESTERTON INVESTMENTS LIMITED, ROBERT WAXMAN, GARY WAXMAN, WARREN WAXMAN, I. WAXMAN & SONS LIMITED, THE GREYCLIFFE HOLDINGS LIMITED ROBIX FINANCIAL CORPORATION LIMITED, CIRCUITAL CANADA INC., RKW STANDARDBRED ASSOCIATES INC., RKW STANDARDBRED MANAGEMENT INC., and GLOW METAL TRADING INC. Defendants	***Alan Lenczner, Lorne Silver*** for the Defendants
A N D B E T W E E N	
I. WAXMAN & SONS LIMITED and CHESTER WAXMAN Plaintiffs by Counterclaim	***Alan Lenczner, Lorne Silver*** for the Plaintiffs by Counterclaim
-and-	
MORRIS WAXMAN, MICHAEL WAXMAN, SHIRLEY WAXMAN, DOUGLAS WAXMAN, THE WAXMAN HOLDING CORPORATION INC., MORRISTON INVESTMENTS LIMITED, SOLID WASTE RECLAMATION LIMITED, SOLID WASTE RECLAMATION INC. and GENERAL ENVIRONMENTAL TECHNOLOGIES CORPORATION Defendants to Counterclaim	***Robert S. Harrison*** and ***Richard B. Swan*** for the Defendants to Counterclaim

Court File #36583/89

B E T W E E N

MORRIS WAXMAN Plaintiff	)	***Robert S. Harrison*** and ***Richard B. Swan*** for the Plaintiff
- and -	)	
I. WAXMAN & SONS LIMITED Defendant	)	***Alan Lenczner, Lorne Silver*** for the Defendant

Court File #37616/89

B E T W E E N

MORRIS WAXMAN, MICHAEL WAXMAN and SOLID WASTE RECLAMATION LIMITED Plaintiffs	)	***Robert S. Harrison*** and ***Richard B. Swan*** for the Plaintiffs
- and -	)	
CHESTER WAXMAN, ROBERT WAXMAN, GARY WAXMAN and I. WAXMAN & SONS LIMITED Defendants	)	***Alan Lenczner, Lorne Silver*** for the Defendants

A N D B E T W E E N

CHESTER WAXMAN, WARREN WAXMAN, ROBERT WAXMAN, GARY WAXMAN, BRENDA HALBERSTADT and I. WAXMAN & SONS LIMITED, Plaintiffs by Counterclaim	)	***Alan Lenczner, Lorne Silver*** for the Plaintiffs by Counterclaim
-and-	)	
MORRIS WAXMAN, MICHAEL WAXMAN, DOUGLAS WAXMAN, SOLID WASTE RECLAMATION LIMITED and THE WAXMAN HOLDING CORPORATION INC. Defendants to Counterclaim	)	***Robert S. Harrison*** and ***Richard B. Swan*** for the Defendants to Counterclaim

Court File #42114/89

B E T W E E N	
MORRIS WAXMAN and MORRISTON INVESTMENTS LIMITED Plaintiffs	***Robert S. Harrison*** and ***Richard B. Swan*** for the Plaintiffs
- and -	
PAUL ENNIS, Q.C. and ENNIS & ASSOCIATES Defendants	***Barbara Murchie, Trent Horne*** for the Defendants

Court File #44142/89

B E T W E E N	
MORRIS WAXMAN and MORRISTON INVESTMENTS LIMITED Plaintiffs	***Robert S. Harrison*** and ***Richard B. Swan*** for the Plaintiffs
- and -	
TAYLOR LEIBOW, WAYNE LINTON and I. WAXMAN & SONS LIMITED Defendants	***Frank Bowman, Chris Hluchan*** for the Defendants Taylor Leibow
	Alan Lenczner, Lorne Silver for the Defendants for the Defendants Wayne Linton and I. Waxman & Sons Limited
	HEARD: July 30, 2002 & August 15, 2002

SANDERSON J.:

SUPPLEMENTARY REASONS FOR JUDGMENT

Introduction

[1] Counsel for the parties appeared before me on July 30, 2002 and August 15, 2002 to make submissions relating to the form and content of the five judgments in actions #33234/88, #36583/89, #37616/89, #42114/89 and #44142/89.

[2] After receiving written submissions, I heard full oral submissions on August 15 with respect to the "tracing" orders, including my jurisdiction to make them, their appropriateness in the circumstances here and their proper scope. I made it clear that if I accepted the submissions of counsel for Chester and his sons, I would revoke or amend my previous orders.

[3] The parties did not dispute that subrules 59.06(1) and 59.06(2) permit me to deal with matters not yet adjudicated and to grant relief other than originally awarded: *Castlerigg Investments Inc. v. Lam* (1991), 2 O.R. (3rd) 216 and *Schmuck v. Reynolds-Schmuck* (2000) 46 O.R. (3rd) 702.

[4] During the course of the day-long argument on August 15, it became obvious that clarification of my Reasons was needed on a number of other matters, and I resolved to issue these Supplementary Reasons to that end before the Judgments in actions #33234/88, #36583/89 and #44142/89 were issued.

The Tracing Orders

The Trust Fund

[5] I have granted a tracing order in respect of 50% of (a) the $250,000 1979 bonuses - $125,000 (the "1979 bonus" or the "1979 bonus monies"), (b) the $6.6 million 1981-1982 bonuses - $3.3 million less $988,000 received - $2,312,000 (the "1981-1982 bonuses" or the "(1981-1982 bonus monies"), (c) the IWS profits wrongfully diverted to companies owned by Robert and Gary - $1,180,073 (the "profit diversions") and (d) the distributions of profit/equity from IWS between December 22, 1983 and June 27, 2000 - as yet unquantified (the "post-Sale profits"). The subject matter of the tracing order is hereinafter collectively "the trust fund".

[6] Millett L.J. pointed out in *Boscawen v. Bajwa,* [1995] 4 All E.R. 769 (C.A.) at p. 776, that equity lawyers habitually use the expressions "tracing claims" and "tracing remedies" to describe the proprietary claims and remedies available in equity to beneficial owners of property. I noted earlier in paragraph 1654 his comment to the effect that, whatever the common usage, tracing, properly so-called, is not a remedy but a process by which a plaintiff traces what has happened to that property, identifies the persons who have handled or received it and justifies his claim that it can be regarded as his. He said that tracing is available with respect to both personal and proprietary remedies. When I referred in paragraphs 1685, 1686, 1687, 1692, 1694 and 1699 of my Reasons to tracing orders, whatever the technical terms sometimes used, including listing, discovery and following, I intended to refer generally to the process by which Morris will be able to ascertain what has happened to the trust fund, how it or a portion of it has moved from person to person or from one asset into another, what property/value now represents the traceable proceeds and to try to recover it or them.

[7] Birks has written in (1992) 45 C.L.P. 69, 85-86:

> Tracing is …the means of finding out where at any relevant minute value is located…

[8] I have found Chester liable to account as Morris' trustee. I have declared the existence of a constructive trust, Chester a constructive trustee, Morris a constructive beneficiary. A.J. Oakley in "Constructive Trusts" (3rd ed., London, Sweet & Maxwell: 1997) has written at p. 12:

> …the existence of the beneficiary's interest under the constructive trust will automatically satisfy both the pre-requisites of an equitable proprietary claim. …The beneficiary of a constructive trust will, therefore, always have a *prima facie* right to bring an equitable proprietary claim against a third party. Nor will it matter if the third party has mixed the property or proceeds with other funds…

Given the nature of Chester's conduct, I have held Morris entitled to elect either proprietary or personal remedies in respect of the trust fund.

[9] Counsel for Chester and his sons submitted on August 15 that the tracing order

> "… proposed here …is without precedent and creates fundamental difficulties of fairness and doesn't complete the trial because the parties are asking to come back for further orders."

[10] He submitted that the Statement of Claim does not refer expressly to a tracing order with respect to post-Sale profits. This court should confine Morris to a personal remedy.

[11] Counsel for the Plaintiffs submitted that the Statement of Claim covers tracing orders including those with respect to post-Sale profits. In paragraph 1(a.1), Morris seeks an order setting aside the Share Sale and December 1983 Lease and further orders, including restitutionary orders, necessary to reinstate him to his legal and financial positions as if the Share Sale and December 1983 Lease had never been executed. An order directing a reference for an accounting is specifically mentioned.

[12] I refer to M. Ellis, *Fiduciary Duties in Canada,* (Toronto: Carswell, 2000) at p. 20-6.2 [Jan 2000]:

> Clearly the most powerful of the fiduciary remedies is that of declaration of trust. By finding that the fiduciary has breached the duty owed, the Court may hold that the defaulting party must account to the beneficiary <u>for the product of the breach</u>. [Emphasis added.] This concept stems from the trust-beneficiary obligation that the former not attain any personal "gain" from the relationship apart from that anticipated by the relationship itself. The prohibition therefore dictates that any such gain is not and never was lawfully in the hands of the defaulting fiduciary as its beneficial owner. The law imposes a trusteeship in the holder in favour of the party to whom the fiduciary owes the duty of fidelity. The "gain" is therefore legally owned by the wronged party: the fiduciary merely "holds" the gain on the other's behalf.
>
> The tracing remedy and the constructive trust declaration are extensions of the finding of trusteeship: the wronged party may "trace" the gain into a mixed fund and/or by-products of the gain in altered form…

[13] Tracing orders and declarations of constructive trust are common restitutionary orders where defaulting fiduciaries are required to account to their beneficiaries to ensure that they cannot profit from their gains.

[14] I have held that Morris has already established entitlement to a proprietary remedy. Millett L.J. explained in *Foskett v. McKeown*, [2000] 3 All E.R. 97 (H.L.), at pp. 122 and 123:

> …where a trustee wrongfully misappropriates trust property… the beneficiary is entitled *at his option* either to assert his beneficial ownership of the proceeds or to bring a personal claim against the trustee for breach of trust. … <u>If the traceable proceeds …are worth more than the original asset, he will assert his beneficial</u>

> ownership and obtain the profit for himself. …The beneficiary's proprietary claims to the trust property or its traceable proceeds can be maintained against the wrongdoer and anyone who derives title from him except a bona fide purchaser for value without notice of the breach of trust. The same rules apply even where there have been numerous successive transactions… …if a trustee buys property partly with his own money and partly with trust money, the beneficiary should have the option of taking a proportionate part of the new property or a lien upon it, as may be most for his advantage. …It is also impossible to distinguish between the case where the mixing precedes the investment and the case where it arises on and in consequence of the investment. … It is also impossible to distinguish between the case where the investment is retained by the trustee and the case where it is given away to a gratuitous donee. The donee cannot obtain a better title than his donor and a donor, who is a trustee cannot be allowed to profit from his trust. [Emphasis added.]

[15] Further, with respect to pre-Sale profits, in their Statement of Claim in paragraph 1(j.3), the Plaintiffs specifically requested a tracing order and in paragraph 1(j.2) they specifically requested relief under s. 248 of the *OBCA*, including a declaration that Morris' 50% share of all monies, benefits … diverted by some or all of the defendants … and all subsequent growth and profits earned therefrom, in whatever form they exist are held by way of constructive trust for Morris … and if appropriate an order directing a reference for an accounting and tracing in respect of such amount.

[16] In *First Choice Capital Fund Ltd. v. First Canadian Capital Corp.*, [1997] 11 C.P.C. (4th) 305 (Sask.Q.B.), Baynton J. said at paragraph 44:

> Blair J. at pp. 149-50 in *Deluce Holdings Inc. v. Air Canada et al.* (1992), 12 O.R. (3d) 131 (Ont. Gen. Div.) describes the court's discretion this way:
>
>> The court has a very broad discretionary power under the oppression remedy legislation to select a remedy appropriate to the situation at hand. Its mandate is to "make any interim or final order it thinks fit". This discretion must be exercised in accordance with judicial principles, of course, and within the overall parameters of corporate law. None the less, the remedy has been described by one early commentator as "beyond question, the broadest, most comprehensive and most open-ended shareholder remedy in the common law world ... unprecedented in its scope": see Stanley M. Beck, "Minority Shareholders' Rights in the 1980s," Special Lectures of the Law Society of Upper Canada, 1982 Corporate Law in the 80s, at p. 312. Courts are prepared to be creative and flexible in fashioning remedies to fit the case when called upon to apply this broad remedy.

[17] In my view, the Plaintiffs' pleading contemplates and covers all the tracing orders granted.

[18] Chester's counsel submitted that tracing is an evidentiary process, which must be completed at trial. Evidence must be led as to the whereabouts of the fund subject to the trust obligation. The Plaintiffs' failure to call evidence to support a tracing order with respect to post-Sale profits caused the Defendants to refrain from calling evidence to defend against such an order. The Defendants have been unfairly precluded from answering.

[19] I disagree. It was clear at trial that Morris was seeking to recover his share of post-Sale profits, including huge bonuses paid by IWS to Chester and his sons. The Plaintiffs attempted to prove they did not constitute reasonable IWS expenses but unwarranted gifts. Counsel for the Defendants did call evidence at trial in an attempt to establish equitable defences, *inter alia*, to a possible tracing order in respect of post-Share Sale profits. They attempted to prove that Chester and his sons provided value for the bonuses received from IWS [i.e. to prove facts to ground the

defence that they were bona fide purchasers for value without notice]. I rejected the evidence quoted in the footnote to paragraph 1097. At paragraph 1099, I found the bulk of the post-Sale bonuses constituted distributions of IWS equity. Nevertheless, I left it open to the Defendants to attempt to prove on a reference that a portion of the post-Sale bonuses were for value, i.e. were reasonable expenses for services provided to IWS [and therefore not trust funds].

[20] The Defendants also called evidence at trial in an attempt to establish an alternative equitable defence, including a defence to a possible tracing order - change of position. They were generally unsuccessful in proving the factual circumstances necessary to ground that defence. I held that Chester has failed to establish a change of position defence. I wish here to make it clear that I have reached a similar conclusion in respect of the entitlement of his sons to change of position defences. At paragraphs 925 and 985, I found that Chester and his sons attended meetings in 1985 and 1987 at which Morris complained about the events of December 1983 [e.g., that Chester waited until Morris might die, had no interest and had him sign documents without discussing their contents]. Morris wanted the Share Sale documents torn up and was asserting continuing ownership of 50% of IWS. Before the 1988 and post-1988 IWS bonuses were declared and paid, Chester and his sons received further specific notice in the form of Exhibit 133, the original Statement of Claim in action 33234/88.

[21] At Volume 4 of their written argument at trial, counsel for the Plaintiffs specifically mentioned they were seeking tracing orders. In their responding submissions, the Defendants did not contend they had not received notice or that they had been deprived of an opportunity to answer.

[22] Given the contents of the pleading, the evidence at trial, and the written argument, it is clear that the Defendants understood throughout that the Plaintiffs were seeking to recover all the components of the trust fund mentioned in paragraph 5, including post-Sale profits and that they were seeking, *inter alia*, proprietary remedies and tracing orders. They were not blindsided or unfairly precluded from answering. In any event, there is no prejudice. I have retained jurisdiction over the conduct of the tracing exercise and have specified that the Defendants may attempt to prove that they did provide value for portions of the post-Sale bonuses. To the extent they are successful, any such sums will not be included in the quantum of post-Sale profits forming part of the trust fund. Morris will have no proprietary interest in such portions of those bonuses or their traceable proceeds.

Pre-Requisites to the Granting of A Tracing Order

[23] Counsel for Chester and his sons submitted there is no precedent for post-judgment tracing orders in the absence of an order for a post-judgment Mareva injunction to preserve assets pending execution, supported by sufficient evidence of dissipation of assets, thwarting of a judgment or other improper activities. He submitted that in the absence of such an order and such evidence, I am without jurisdiction to make tracing orders.

[24] If preservation of assets were the issue before me, I would have held that the Plaintiffs have proved improper activities and thwarting of Morris' legitimate interests sufficient to warrant an order preserving assets pending execution. I have found that on Chester's direction,

the value of IWS was largely denuded over many years, both before and after December 22, 1983. Chester and his sons together attempted to deny Morris' rights. Huge bonuses were declared immediately after the litigation was commenced. Chester and Robert deliberately withheld crucial documents; Robert tampered with others.

[25] However, at this stage, the tracing order is not in support of a Mareva injunction prior to trial but in support of legal and equitable rights conclusively proven at trial. Morris is entitled to information respecting the trust fund which tracing should reveal, in order, *inter alia*, to help him choose among the remedies to which I have already held him entitled.

<u>The Proper Tracing Sequence</u>

[26] Counsel for the Defendants submitted that, having failed to call evidence at trial about the transfer of the trust fund into the hands of others or its substitution in the same or other hands for other assets/value, the Plaintiffs should not be allowed to cure the deficiency by gathering information and tracing in stages. It is not correct to speak of a post-judgment tracing order.

[27] I do not accept that it was encumbent upon counsel for the Plaintiffs to explore on discovery and to call evidence at trial about the present whereabouts, value and content of the trust fund. I have no doubt that if Chester and his sons had been questioned at discovery or trial about those matters, they would have refused to answer, *inter alia*, on the ground that such inquiries were inappropriate and premature.

[28] Were courts to require parties to call such evidence at trial, the cost and length of litigation would be greatly increased. Further, the Plaintiffs are entitled to information about <u>present</u> whereabouts and value.

[29] Counsel for the Plaintiffs submitted that orders allowing parties to trace <u>after</u> judgment to ascertain (a) what has happened to trust monies and (b) what assets/value now represent the trust fund are common and fully warranted. They cited *Mercantile Group (Europe) A.G. v. Aiyela et al.*, [1994] 1 All E.R. 110 (C.A.) and *Chase Manhattan Bank N.A. v. Israeli-British Bank (London) Ltd.,* [1981] 1 Ch. 105, as examples.

[30] In the former case, an order was made post-judgment:

> … requiring Mr. Aiyela's [a wrongdoer's] wife to provide information to assist the plaintiffs in tracing the assets, …[including] detailed financial information about herself and her husband; … particulars of companies or trusts which she or her husband had caused to be formed …and assets which they held: her own and her husband's bank accounts, credit card accounts, properties, motor cars, and other chattels.

[31] In the latter case, Chase Manhattan sued the Israel-British Bank to recover \$2-million paid to it by mistake, and asserted a proprietary claim. Justice Goulding said:

> at p. 116: "At this stage, <u>I am asked to take only one step forward, to answer the initial question of principle: whether the claimant is entitled in equity to trace the mistaken payment and to recover what now properly represents the money. The subsequent history of the payment and the rules for ascertaining what now represents it have not been proved or debated before me. They will have to be established in further proceedings if the plaintiff can clear the first hurdle</u>"…

> at p. 128: "Subject to any discussion of the wording, I will declare that on July 3, 1974, the defendant became trustee for the plaintiff of the sum mentioned in paragraph 4 of the re-amended statement of claim, and I will direct an inquiry of what has become of that sum and what assets, if any, in the possession or power of the defendant now represent the said sum, or any part thereof, or any interest or income thereof. The further consideration of the action will be adjourned, and the parties will be at liberty to apply as they may be advised." [Emphasis added.]

Entitlement to trace was first established and then the tracing process was used to determine what had become of a trust fund and its traceable proceeds.

[32] In *Re Diplock Estate*, [1948] 2 All E.R. 318 (H.L.) a testator directed in his will that the residue of his estate should be paid to undefined charitable institutions in England. His executors paid out over £200,000 to 139 different charities over a period of about four years. The will was then challenged. In 1944, the House of Lords held that that bequest was void. Actions were later commenced to recover the funds. The plaintiffs were successful in tracing and recovering a large portion of their funds from the charities.

[33] In my view, the Plaintiffs are not precluded by reason of the earlier fact that they did not call evidence about the present whereabouts and value of the trust fund at trial from obtaining information about what has become of the trust fund, where it is now and what assets now represent it. The tracing process now will include inquiries about the present whereabouts of the trust fund. Knowledge of the whereabouts of the trust fund at the time of trial would be of limited assistance in enforcing Morris' equitable rights today.

[34] Counsel for the Plaintiffs submitted that tracing orders are commonly implemented in stages. Courts have commonly required defendants to file affidavits listing assets.

[35] In *First Choice Capital Fund Ltd., supra,* allegations of misappropriation of investment funds by the two respondents were made. At a pre-trial stage, the applicant sought a collateral discovery order. Baynton J. ordered the two respondents to list their world-wide assets and to include particulars of:

> …all monies, assets, 'choses in action', and other property of any nature acquired directly or indirectly from dealings with the plaintiff corporations, and, in addition, particulars of ownership of each item of property, and particulars as to disposition of items or property that have been disposed of.

[36] Pre-trial listing orders frequently require defendants to list all assets. I think that, at least initially, a distinction should be made between the purpose of listing in support of a Mareva injunction [i.e., to locate all assets of a wrongdoer and to prevent their dissipation] and listing in aid of tracing a particular trust fund, after beneficial ownership has been established at trial [i.e., to assist a wronged plaintiff to recover it and to knowledgeably choose among remedies to which he is entitled.] The first focus of the listing component of my tracing order here should be the whereabouts and traceable proceeds of the trust fund - the 1979, 1981-1982 bonuses, profit diversions and post-Sale profits. Initially Chester, Robert, Warren and Gary must list and file detailed information under oath about their receipt and holding of the trust monies, from the time of receipt to the present, what has become of them, and what assets, monies, choses in action and other property of any nature, now represent those sums or any part thereof. They must also disclose any income or interest earned on those sums and particulars as to disposition.

[37] As part of the tracing exercise, courts have also commonly required the defendants to submit to cross-examination and discovery and I am of the view that they are appropriate here. The Plaintiffs will not be limited to cross-examining Chester and his sons on the contents of the listing affidavits mentioned in the previous paragraph. Their counsel may also question them about the contents of the other documentation that I have also ordered them to produce. I have held Morris entitled to choose to enforce personal remedies against the Defendants. Tracing may be used to enforce personal remedies. In my view, Morris as a 50% owner of IWS is entitled to items (i) to (v) in paragraph 11 of the proposed Judgment, even apart from any tracing order. Further, a review of IWS documentation including and after 1993 will be necessary on the reference that I have ordered to determine whether any of the proceeds of the Philip sale are still in IWS. Items (vi) to (xiii) refer to personal records of the Defendants and their companies, which are relevant to substitution of trust funds for other assets, choses in action or property. Apart from the tracing order, Chester and his sons could be compelled on judgment debtor examinations to fully disclose all assets, choses in action, etc., presently owned. I am ordering production now of all documentation relevant to personal and proprietary remedies, in an attempt to avoid, where possible, repeated attendances on examinations, including judgment debtor examinations.

[38] In *Bankers Trust Co. v. Shapira,* [1980] 3 All E.R. 353 (C.A.), Lord Denning emphasized that court-ordered discovery is an essential element of the tracing process. As information is made available, the possible need for further information may become apparent and motions for further information, documents and examinations may be made.

[39] Counsel for the Plaintiffs may also examine Mr. Wiseman under oath. He clearly has relevant information and has already proven to be a more reliable and forthcoming source of information than Chester and his sons. I order Chester to pay Wiseman's fees and disbursements in connection with that examination and production of documents.

[40] The procedure adopted by C. Campbell J. in *Gold Chance International Ltd. v. Daigle & Hancock*, [2000] O.J. No. 2194 (S.C.J.) is but one example of a court following a progressive approach [albeit in a pre-trial context where asset preservation rather than asset recovery was being sought]:

> a) On April 20, 2000, he granted an interlocutory order requiring, *inter alia,* the defendants to deliver under oath a complete and detailed listing of their assets to a receiver appointed by the court; requiring that the defendants deliver bank records, corporate books and records, etc. to the receiver; issuing letters of request for the examination of third parties;
>
> b) On May 1, 2000, he granted an order allowing the plaintiffs to examine certain of the defendants under oath;
>
> c) On May 5, 2000, and at later dates, he granted an order allowing the issuance of letters of request to allow for enquiries to be made as to whereabouts of the certain funds;
>
> d) Various procedural motions unrelated to the tracing order followed. Summary judgment was granted by C. Campbell J. against certain defendants on March 8, 2001, but refused against others on March 10, 2001.

[41] While I agree with counsel for Chester and his sons that the tracing process may require a number of attendances and rulings in successive stages, I do not accept his submission that this Court lacks jurisdiction post-trial to direct and supervise the process.

[42] Courts of equity should strive to ensure that their judgments will not be rendered meaningless. They may draw upon the arsenal of equitable remedies or processes available to enforce equitable rights. In *Alberta (Treasury Branches) v. Leahy*, [2000] A.J. No. 993 (Q.B.); aff'd (*sub. nom Albert (Treasury Branches) v. Ghermezian*, [2002] A.J. No. 524 (C.A.), Mason J. said of equitable discovery:

> The Courts in both England and Canada have extended the equitable remedy of discovery as revitalized by *Norwich* to combat the stratagems and chameleon antics of fraudsters. The principles have been further extended and applied to numerous subsequent cases so as to not only identify wrongdoers but to trace funds and assets and even to assist a prospective plaintiff in determining whether a cause of action exists. The evolution of the remedy has focussed on the extension and development of the 'full information' portion of the relief as opposed to simply discovering the identity of the wrongdoer. This largely occurred in actions to trace funds fraudulently taken or mistakenly misappropriated and then wrongfully withheld.

[43] In *First Choice Capital Fund Ltd., supra,* Baynton J. said:

> **at paragraph 51** In A.J. Bekhor & Co. Ltd. v. Bilton, [1981] 2 W.L.R. 601 (C.A.), Griffiths L.J. stated as follows at p. 621
>
>> ... from time to time cases will arise when, although it seems highly probable that the defendant has assets within the jurisdiction, their precise form and whereabouts are in doubt, or in the case of a number of defendants they may collectively have sufficient assets but there may be doubt about the distribution among themselves. In such cases in order that the Mareva injunction should be effective both the court and the plaintiff require to know the particular assets upon which the order should bite. It must be remembered that the underlying reason for making the order is the fear that the defendant may remove his assets and this is most effectively prevented by the plaintiff serving a copy of the injunction on whoever is holding the defendant's assets for the time being. Very often this will be the defendant's bankers, but assets can take many forms and be in the hands of many different persons to whom it is desirable to give notice of the court's order. To my mind the desirability of the power to order discovery is obvious and it is particularly needed in the case of a defendant who has demonstrated himself to be untrustworthy and evasive ...
>>
>> ... If the court has the power to make a Mareva injunction it must have power to make an effective Mareva injunction. If the injunction will not be effective it ought not to be made.
>>
>> For the reasons I have already given it may be necessary to order discovery to make the injunction effective and I would hold that the court has the power to make such ancillary orders as are necessary to secure that the injunctive relief given to the plaintiff is effective. I therefore agree that a judge does have power to order discovery in aid of a Mareva injunction if it is necessary for the effective operation of the injunction
>
> **at paragraph 52**. In Derby & Co. Ltd. v. Weldon (No. 2), [1989] 1 All E.R. 1002 (H.L.), the House of Lords cited the H.A. Bekhor case. Neill L.J. commented on the value of a discovery order in aid of a Mareva injunction in the following colourful way, at p. 1021:
>
>> In the course of this appeal some reference was made to the fact that assets, like the Cheshire cat, may disappear unexpectedly. It is also to be remembered that modern technology and the ingenuity of its beneficiaries may enable assets to depart at a speed which can make any feline powers of evanescence appear to be sluggish by comparison
>
> **at paragraph 56**. The circumstances of this case cry out for injunctive relief. The subject matter of this litigation is much different than a claim by a lender for an unpaid loan or a claim by a supplier for an unpaid

> debt. Rather it is a claim by oppressed investors that includes in part a claim for the return of misappropriated investment funds. From one respect a portion of the action is of the nature of a claim for the return of trust funds held by the respondents as constructive trustees. The findings made previously by this Court and upheld by the Court of Appeal clearly indicate that the respondents Machula and O'Brien took a predatory approach to the investors' funds and benefitted inappropriately from them. The inspector observed that they treated the funds as if they were their own private bank. Considering the oppressive nature of this conduct respecting the investment funds and their continuing reticence to disclose particulars of the financial operations of FCCC, there is a substantial risk that the benefits the respondents derived through their involvement in the funds will not be available to the investors by the time their entitlement to a judgment is determined at trial. If this risk materializes and the investors are successful, their victory will be hollow and meaningless and this litigation will have been futile.

[44] I would have thought it evident that as tracing orders are available to litigants before trial to prevent disposition of all assets where a plaintiff's case appears to be strong, tracing orders should also be available to recover misappropriated trust funds after legal or equitable rights have been conclusively proved at trial.

[45] Hoffman L.J. said in *Mercantile Group (Europe) AG v. Aiyela, supra* at 115:

> It would be very strange if before judgment the plaintiff could …obtain information from third parties about the whereabouts of the debtor's assets but was limited after judgment to examining the debtor under RSC Ord 48, r.1

In the same case, Sir Thomas Bingham said at 117:

> …if jurisdiction did not exist the armoury of powers available to the court to ensure the effective enforcement of its orders would in my view be seriously deficient. That is in itself a ground for inferring the likely existence of such powers, since it would be surprising of the court lacked power to control wilful evasion of its orders by a judgment debtor …

[46] Huddart J. in *Mooney v. Orr* (1994), 33 C.P.C. (3d) 31 (B.C.S.C.) said at 50:

> The circumstances of each situation will determine whether justice requires an injunction and a listing of assets or the transfer of assets to a receiver, not to enhance the claimant's rights, but to ensure that those reasonable people who pay for the administration of justice in this province are not affronted by the impotence of the court in the face of those who choose to order their affairs so as to keep all their options for themselves.

[47] In my view, while those cases involve different equitable remedies or processes at different stages of litigation, the same reasoning applies here. I am fortified in my view by the statement of Millett L.J. in *Foskett, supra*, in a passage quoted at paragraph 1654 of my Reasons, at p. 120:

> The successful completion of a tracing exercise may be preliminary... <u>to the enforcement</u> of a legal right…or an equitable one.

<u>The Scope of the Tracing Order</u>

[48] Counsel for Chester and his sons objected to the "practical difficulty" which the tracing orders will create. Using the example of bonus money paid to Chester's sons, he said, "If it is commingled with all kinds of other money and no particular asset is purchased, you embark upon a nightmare."

[49] While I accept that the process may be complex, I agree with Ellis, *supra* at 20-14.2:

> The court's willingness to require a defaulting fiduciary to account for gain will not be foiled by the complexity of following the property or its derivation, into a mixed fund in the hands of the defaulting party or even the hands of a third party…

[50] In my view, the complexity of the process should not deter this Court from ordering and overseeing it.

[51] Privacy rights of the Defendants are not a valid concern. Baynton J. said in *First Choice, supra,* at p. 329:

> **80**. The respondents maintain that a discovery order will unduly interfere with their privacy rights. The short answer to this objection is that when the respondents oppressed the applicants by inappropriately taking their investment funds, they subjected their privacy rights to the rights of the applicants to the discovery of what became of the funds that were taken.

<u>The 1979 Bonus Monies</u>

[52] Chester's counsel submitted in his factum that there is no need to trace the 1979 bonuses, as it is already known they were paid to Gary, Warren and Robert.

[53] I have held that Morris is entitled to a continuing beneficial interest, not only in $125,000 of 1979 bonuses but also in its traceable proceeds. Chester's sons received the 1979 bonus monies as gratuitous volunteers, not as bona fide purchasers <u>for value</u> without notice. They may be traced or followed into their hands or into their proceeds.

[54] Morris needs to determine what has happened to the 1979 bonus monies and their proceeds, in order to be in a position to knowledgeably enforce his rights. A tracing order should enable Morris to identify all past and <u>present</u> holders/recipients of the trust fund as well as the value inherent in the traceable proceeds to the present time.

<u>1981-1982 Bonuses</u>

[55] I have held that Morris was entitled to receive $3.3 million in 1981-1982 IWS bonuses. He received only $988,000.

[56] Counsel for Chester and his sons submitted "there is no need for a tracing order in respect of 1981-1982 bonuses and one was not granted…"

[57] I disagree. In paragraph 1694 of my Reasons, I held that Morris was entitled to trace the 1981-1982 bonuses. I gave him the option of electing between proprietary remedies and personal remedies in respect thereof.

[58] I have found that Chester's sons did not deserve the 1981-1982 IWS bonuses they received. They were gratuitous volunteers, not bona fide purchasers <u>for value</u> without notice.

[59] I have already noted Millett L.J.'s statement in *Foskett, supra* that "it is impossible to distinguish the case where the money is retained by the trustee and given away to a gratuitous

donee." In *Foskett, supra*, the wrongdoer Murphy used stolen money to pay premiums on an insurance policy for the benefit of his children. They were unaware he had used misappropriated funds and were innocent of any personal wrongdoing. However, the Court held they were volunteers whose interest derived from the wrongdoer, not contributors for value. As such, they were in no better position than he would have been had he retained the policy for the benefit of his estate**.** Millett L.J. said at pp. 119-120:

> …the purchasers have chosen <u>at each stage</u> to trace the money into its proceeds, viz the debt presently due from the bank to the account holder or the debt prospectively and contingently due from the insurance company to the policyholders.
>
> Having completed this exercise, the purchasers claim a continuing beneficial interest in the insurance money…. The transmission of a claimant's property rights from one asset to its traceable proceeds is part of our law of property, not of the law of unjust enrichment. There is no "unjust factor" to justify restitution (unless "want of title" be one, which makes the point.) The claimant succeeds if at all by virtue of his own title, not to reverse unjust enrichment. Property rights are determined by fixed rules and settled principles. They are not discretionary. They do not depend upon ideas of what is 'fair, just and reasonable.' Such concepts, which in reality mask decisions of legal policy, have no place in the law of property.
>
> <u>A beneficiary of a trust is entitled to a continuing beneficial interest not merely in the trust property but in its traceable proceeds also, and his interest binds everyone who takes the property or its traceable proceeds except a bona fide purchaser for value without notice.</u> In the present case, the purchaser's beneficial interest plainly bound Mr. Murphy, a trustee who wrongfully mixed the trust money with his own, and whose every dealing with the money (including the payment of the premiums) was in breach of trust. It similarly binds …Mr. Murphy's children who are volunteers. They gave no value for what they received and derive their interest from Mr. Murphy by way of gift." [Emphasis added.]

[60] I have <u>also</u> found Chester's sons <u>personally</u> liable to Morris for knowing receipt of the 1981-1982 bonuses. I noted in my Reasons, at paragraphs 1620-1622, that there is some debate about the proper scope of the remedy for knowing receipt. At paragraph 1622, I quoted the following: "Personal recipient liability in equity fills an important gap in the scheme of private law remedies where it is impossible to trace or impractical to trace…" I have held that Morris is entitled, <u>at the least</u>, to personal remedies against Chester's sons to the extent that they received 1981-1982 bonuses, quite apart from my tracing orders in respect of them.

[61] In *Citadel General Assurance Co. v. Lloyds Bank Canada*, [1997] 3 S.C.R. 805, LaForest J. said at paragraphs 58 and 59:

> "**58**. In my view, a distinction should be made between the imposition of liability in "knowing receipt" cases and the availability of tracing orders at common law and in equity. Liability at common law is strict, flowing from the fact of receipt. Liability in knowing receipt cases is not strict; it depends not only on the fact of enrichment (i.e. receipt of trust property) but also on the unjust nature of that enrichment (i.e. the stranger's knowledge of the breach of trust.) A tracing order at common law, unlike a restitutionary remedy, is only available in respect of funds which have not lost their identity by becoming part of a mixed fund. Further, the composition of liability as a constructive trustee is wider than a tracing order in equity. The former is not limited to the defence of purchaser without notice and does not depend upon the recipient still having the property or its traceable proceeds…
>
> **59**. Despite these distinctions, there appears to be a common thread running through both "knowing receipt" and tracing cases. That is constructive knowledge will suffice as the basis for imposing liability on the recipient of misdirected trust funds. Notwithstanding this, it is neither necessary nor desirable to confuse the traditional rules of tracing with the restitutionary principles now applicable to "knowing receipt" cases. This does not mean, however, that a restitutionary remedy and a tracing order are mutually exclusive. Where more than one remedy is available on the facts, the plaintiff should be able to choose the one that is most

> advantageous. In the present case, the plaintiff did not seek a tracing order. It is therefore unnecessary for me to decide whether such a remedy would have been available…"

[62] The mention of the requirement of constructive knowledge in a tracing context in *Citadel* was obiter and was made before *Foskett, supra* was decided on different facts. Assuming without deciding that constructive knowledge is required, that requirement is met here. I have found Chester's sons had at least constructive knowledge of Chester's breach of fiduciary duty/trust in respect of the 1981-1982 bonuses.

The Profit Diversions

[63] Similar considerations apply to Morris' entitlement to trace profits totaling $1,180,073 wrongfully diverted from IWS to companies owned by Robert or Robert and Gary.

[64] Counsel for Chester and his sons submits that a tracing order is unnecessary, as evidence was led at trial about the recipients of those profit diversions.

[65] I disagree. A tracing order should enable Morris to identify all past and present holders/recipients of the trust fund and the present value of its traceable proceeds, i.e., to determine what has become of the $1,180,073, the portion of the trust fund representing those profit diversions.

Post-Sale Profits

[66] At paragraphs 1093 to 1101 of my Reasons, I found that between 1984 and 1993, IWS declared bonuses in favour of Chester and his sons totaling at least $24,258,000, as follows: in Chester's favour: $625,000 in 1985, $600,000 in 1986, $2,100,000 in 1987, $3,000,000 in 1988, $2,500,000 in 1989, $1,700,000 in 1990, $1,000,000 in 1991; in Robert's favour totaling at least $6,425,000, as follows: $1,000,000 in 1987, $2,500,000 in 1988, $1,425,000 in 1989, $1,500,000 in 1990; in Warren's favour totaling at least $3,250,000, as follows: $4,000 in 1986, $7,500 in 1987, $1,700,000 in 1988, $1,300,000 in 1989, $250,000 in 1990; in Gary's favour totaling at least $3,025,000, as follows: $4,000 in 1986, $12,500 in 1987, $1,550,000 in 1988, $1,225,000 in 1989, $250,000 in 1990. I also set out the amounts of dividends paid only to Chester.

[67] Warren and Gary were working primarily or completely for IWS Ferrous, not IWS. Yet in 1988 and 1989, for example, they received bonuses from IWS well in excess of the total tonnage fees paid to IWS by IWS Ferrous [i.e., more than the total revenue being generated by IWS Ferrous for IWS.]

[68] I rejected Chester's evidence on the value of his own contributions and those of his sons. I preferred and accepted that of Cole. I found that the bonuses by and large were not real expenses of IWS. Payment of all or most of the post-Sale bonuses constituted an improper distribution of IWS profits/equity.

[69] I directed that if Morris so elects, Chester must precisely account to Morris for post-Sale profits on a reference. Alternatively, I held that Morris may choose to receive my estimate of Morris' share of the post-Sale profits, adjusted post-Sale by amounts representing reasonable

expenses payable by IWS to Chester and his sons for their services to be described and determined on a reference. I held that the bulk of IWS bonuses paid to Chester and his sons after 1983 did not represent reasonable expenses of IWS. However, I directed that the quantum of expenses representing reasonable remuneration for their services to IWS be quantified, and that post-Sale profits be adjusted accordingly. To the extent the bonuses were not reasonable, I held Chester's sons were not bona fide purchasers for value without notice.

Summary of Conclusions Respecting Tracing

[70] I have found that Morris is entitled to choose between personal or proprietary remedies in respect of the trust fund. Where one asset has been exchanged for another, he may elect to follow the original asset into the hands of the new owner or to trace its value into the new asset in the hands of the same owner. He may substitute the traceable proceeds for the original asset. To knowledgeably choose and enforce his proven rights, he must be able to understand what has become of the various components of the trust fund and what property/value now represents them or any part of them. Any interest or income from them must be disclosed.

[71] The tracing exercise may be complex and time-consuming as it progresses in stages. That is no reason to deny tracing orders. Neither was it necessary at trial nor is it now necessary to make prospective rulings on defences that may be raised by persons other than Chester and his sons into whose hands trust funds may be traced (i.e, to determine whether they are bona fide purchasers for value without notice or have changed their positions in such a way so as to make the imposition of proprietary remedies unjust.) The rights of non-parties may be separately addressed as they arise.

[72] Having reviewed the clauses in the proposed form of order relating to tracing and subject to the changes required by these Supplementary Reasons, I am of the view that it specifies reasonable first steps to initiate the tracing process here. Document production, listing under oath as specified and examinations of parties liable are appropriate in all the circumstances here. Morris is entitled not merely to determine what assets the Defendants presently have, as on a judgment debtor examination, but also to trace to determine where the trust fund is presently, through whose hands it has passed, and/or what assets/value it now represents. My tracing order relates to the receipt, holding and possible substitution and disposition of trust monies by Chester and his sons over a period from 1979 to the present. Personal information and documentation will be relevant on examination for the purpose of identifying traceable proceeds. I am ordering documentation to be produced now so that re-attendances by Chester and his sons [with the attendant costs and inconvenience to all involved] may be avoided to the greatest extent possible.

[73] If and when further submissions are necessary with respect to Morris' claim to individual assets or traceable proceeds and with respect to the Defendants' defences to them, I shall entertain them as they arise.

Other Issues Requiring Clarification and Affecting The Form and Content of the Judgments

Action # 33234/88

[74] On August 15, counsel for the Plaintiffs sought an order expressly declaring the Share Sale and December 1983 Lease void *ab initio* and setting them aside. He mentioned certain portions of my Reasons, including paragraphs 757, 761 and 1420, which might be read as indicating my intention to effect that result.

[75] Sufficient bases undoubtedly exist to warrant such declarations in favour of Morris and Morriston. I have found the Share Sale to be 'manifestly and patently unfair' (paragraph 734), 'grossly unfair' (paragraph 1281), 'manifestly disadvantageous' (paragraph 1345) and 'improvident and unconscionable' (paragraph 1420). I have found the rental rate in the December 1983 Lease to be 'patently unfair' (paragraph 761) and have commented that the lands covered by the Lease were 'practically speaking being expropriated for next to nothing' (paragraph 761.)

[76] If I had been deciding the issues soon after December 1983, I would not have hesitated to so declare. However, almost twenty years have passed since December 22, 1983. Over many of those years, IWS has been carrying on business and has been entering into contracts with persons having no knowledge of the matters outlined in my Reasons. I do not want to imperil the validity of contracts between IWS and arm's length third parties, for instance those in 1993 with Philip and existing leases with any arm's length tenant/tenants.

[77] In "Fiduciary Duties in Canada," *supra* referring to *Lac Minerals*, Ellis said at 20-10:

> "…a finding of trust after the fact …by a declaration of trusteeship necessitates the conclusion that the "beneficiary" is enforcing the agency of the defaulting party rather than calling for compensatory damages equal to the fiduciary's gain. When analysed in this manner, all improvements are logically expenditures on behalf of the "beneficiary." The only logical exceptions conceptually would be the unreasonable nature of the expenditures…

At 20-9 [2002 Rel. 2], Ellis wrote:

> "…it is clear that the "gain" will be calculated net of the reasonable costs incurred by the defaulting party to attain it. The reason why the "gain" to be accounted for is net of expenses is the fiction that the defaulting fiduciary will be deemed under a declaration of trust to have acted as a trustee and therefore on behalf of the wronged party throughout the breach…"[Emphasis added.]

I have not declared the Share Sale *void ab initio*. I have ordered that 50% of the IWS shares be restored to Morris as of June 27, 2002. In the meantime, I have declared Chester to be a constructive trustee, Morris to be a constructive beneficiary. Chester must account for post-Sale profits on those shares between December 22, 1983 and June 27, 2002, should Morris so choose.

[78] I have found that the December 1983 Lease documents were executed on December 22, 1983 in the context of the Share Sale. My findings with respect to their unfairness to Morris and Morriston were made in light of Chester's expectation that he would be a 100% owner of IWS during the lease term. However, in my disposition with respect to the Share Sale I have in effect

provided that their extreme unfairness to Morris/Morriston and Chester/Chesterton be borne equally by Morris and Chester as beneficiaries of 50% of the profits of IWS. So long as IWS is owned equally by Morris and Chester, the owners of Morriston and Chesterton, it is reasonable to enforce the lease to ensure that IWS is able to operate.

[79] During his submissions on July 30, 2002, counsel for Chester and his sons mentioned that on August 15, 2002 he might be seeking an order to wind up IWS. Although he did not pursue such an order, I asked him on August 15 for his position on the continuing validity of the December 1983 Lease in the event of IWS' dissolution. He replied, "That is the end of the lease, I would expect."

[80] Counsel's July 30 comment raised a possible scenario that would render continuing enforcement of the Lease unjust. If IWS were wound up and the Lease were nevertheless enforced thereafter, unfairness would result to Morriston and Chesterton. Unfairness from continuing enforcement of the December 1983 Lease could also result were Morris and Chester no longer to be 50/50 owners of IWS, sharing equally in the benefits to IWS, Morriston/Chesterton sharing equally in its detriments. Therefore, I order that if IWS is wound up or if any of its shares are further transferred during the term of the Lease, Morriston or Chesterton will have the option of terminating that lease. Such an order is expressly subject to the rights of any persons who have entered into arm's length sub-leases with IWS.

Joint or Several Liability

[81] During the argument on August 15, it was obvious that clarification is needed on the nature of the liability of Chester and IWS [i.e., whether it is joint and several or several.]

[82] In all of the circumstances of this case, I am of the view that it would be inequitable to allow Chester and to require Morris in effect to satisfy this judgment [on a claim over involving IWS] in large measure using Morris' own money or assets. The liability of IWS and Chester is several, not joint and several.

Does Morris Take 50% of the IWS Shares Free of Encumbrances?

[83] The Plaintiffs asked me to make it clear that Morris is to take 50% of the shares of IWS as of June 27, 2002 "free of all encumbrances."

[84] There was no evidence before me at trial on that point. I am not prepared to accede to that request. Morris must take his interest subject to valid existing encumbrances. However, should it be determined that the shares have been encumbered under questionable circumstances, the parties may apply for an order setting them aside.

Set Off

[85] The Plaintiffs are also seeking to set off the $51,058.02 that I have ordered Morris to pay to IWS in the counterclaim against amounts that I have ordered IWS to pay to Morris.

[86] Section 111 of the *Courts of Justice Act* R.S.O., 1990 c. C.43 provides that in an action for payment of a debt, a defendant may, by way of defence, claim to set off a debt owed to the defendant by the plaintiff against the plaintiff's claim.

[87] While I am of the view that it would be inappropriate were IWS/Chester to attempt to collect the $51,058.02 from Morris in the period pending appeal in the circumstances here, no request for a set-off was made in the Defence to Counterclaim. Therefore, the Plaintiffs' request is denied.

Personal Liability for Post-Sale Profits

[88] Since I gave Chester and his sons the right to prove value for a portion of the post-Sale bonuses for services provided to IWS, it was not possible in my Reasons to precisely specify the quantum of post-Sale profits for which Chester is, at the least, personally liable to Morris as his trustee. Nor could I specify the post-Sale profits, for which Robert, Warren and Gary are, at the least, personally liable for knowing receipt. I have always intended, after reasonable post-Sale expenses have been determined on a reference as described in paragraphs 1676 to 1682 and after appropriate adjustments have been made to the amounts of post-Sale profits so determined, to hold Chester's sons personally liable for amounts [as adjusted] that they received, altogether apart from the tracing order which I have made in connection with the post-Sale profits. Of course, no double recovery will be allowed. The Judgment should so provide.

Continuing Jurisdiction

[89] Counsel for the Defendants concedes that if tracing orders are appropriate at all, my continuing involvement in tracing matters is appropriate. However, he objects to a provision in the Judgment i.e., that any party may re-apply to Sanderson J. for further directions and ancillary orders arising out of her decision in this action, conferring jurisdiction on me with respect to other matters after issuance of the Judgment.

[90] In my Reasons, I have left open a number of matters, for example, the parties' right to make further submissions on the terms of the reference for an accounting. I am of the view that a paragraph in the Judgment providing that any party may apply to me for further directions and ancillary orders arising out of my decision in this action is both appropriate and necessary.

The References

[91] In my Reasons, I failed to specify under Rule 54.03 that the references to which I have referred are to be conducted by a Master of this Court.

Action # 44142/89

[92] Counsel for the Plaintiffs requested a provision in the Judgment as follows:

> …any party may make further submissions to Sanderson J. if Canada Customs and Revenue Agency does not repay to Morris Waxman the taxes paid in connection with the purported sale of the shares of IWS to Chester Waxman, and that Sanderson J. shall remain seized of the matter in this respect.

[93] Counsel for Taylor Leibow submitted that it is necessary to distinguish between taxes paid by Morris following the Share Sale and the tax liability with respect to the staged versus final sale issue and the 56-1/4 shares held by Shirley Waxman. The Plaintiffs have not advanced any claim against Taylor Leibow with respect to the former.

[94] I agree with counsel for Taylor Leibow on that point. My findings of negligence against Taylor Leibow relate to the staged v. completed sale issue.

[95] Therefore, the proposed Judgment in action 44142/89 should be reworded and limited to possible re-attendances before me in the event that a higher court finds that Morris' entitlement to benefit from post-Sale profits of IWS is limited to the benefits of ownership resulting from a staged sale.

Continuing Jurisdiction

[96] In my Reasons, I specified that certain costs submissions be filed by September 16, 2002. On August 15, counsel agreed that the Plaintiffs would serve and file their submissions first and that the Defendants would then respond. I have extended the date for the Plaintiffs' submissions to October 1, 2002. The Defendants must respond by October 15, 2002.

M. A. SANDERSON J.

Released:

COURT FILE NOS. #33234/88, #36583/89, #37616/89, #42114/89, #44142/89
DATE: 20020916

ONTARIO
SUPERIOR COURT OF JUSTICE

B E T W E E N:

MORRIS WAXMAN and MORRISTON INVESTMENTS LIMITED Plaintiffs

- and -

CHESTER WAXMAN, CHESTER WAXMAN, in trust, CHESTERTON INVESTMENTS LIMITED, ROBERT WAXMAN, GARY WAXMAN, WARREN WAXMAN, I. WAXMAN & SONS LIMITED, THE GREYCLIFFE HOLDINGS LIMITED ROBIX FINANCIAL CORPORATION LIMITED, CIRCUITAL CANADA INC., RKW STANDARDBRED ASSOCIATES INC., RKW STANDARDBRED MANAGEMENT INC., and GLOW METAL TRADING INC. Defendants

A N D B E T W E E N

I. WAXMAN & SONS LIMITED and CHESTER WAXMAN
Plaintiffs by Counterclaim

-and-

MORRIS WAXMAN, MICHAEL WAXMAN, SHIRLEY WAXMAN, DOUGLAS WAXMAN, THE WAXMAN HOLDING CORPORATION INC., MORRISTON INVESTMENTS LIMITED, SOLID WASTE RECLAMATION LIMITED, SOLID WASTE RECLAMATION INC. and GENERAL ENVIRONMENTAL TECHNOLOGIES CORPORATION
Defendants to Counterclaim

SUPPLEMENTARY REASONS FOR DECISION

M.A. SANDERSON J.

Released: September 16, 2002

TAB 4

CITATION: Credifinance Securities Limited (bankruptcy), 2010 ONSC 984
COURT FILE NO.: 31-1249035
DATE: 20100216

SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)

RE: IN THE MATTER OF THE BANKRUPTCY OF CREDIFINANCE SECURITIES LIMITED

BEFORE: Mr. Justice F. Marrocco

COUNSEL: *Gregory Sidlofsky*, for the Appellant

Catherine Francis, for the Trustee, Deloitte & Touche Inc.

DATE HEARD: December 15, 2009, & January 6, 2010

ENDORSEMENT

MARROCCO J.:

[1] Credifinance Securities Limited made an assignment in accordance with the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, on August 24th, 2009. DSLC Capital Corp. filed a proof of claim in the amount of $400,000 on September 9, 2009. In its proof of claim, DSLC Capital Corp. maintained that the sum of $310,500 in the possession of Credifinance Securities Limited was its property. On September 25, 2009, Deloitte & Touche Inc., in its capacity as Trustee of the estate of Credifinance Securities Limited, denied the claim in full. DSLC Capital Corp. appeals that decision in this proceeding.

[2] On this appeal, the position of DSLC Capital Corp. is that it is the victim of a fraud at the hands of Georges Bennaroch and that, as a result of that fraud, it loaned $400,000 to Credifinance Securities Limited. According to DSLC Capital Corp., the $310,500 is directly traceable to that $400,000 loan and, therefore, should be impressed with a constructive trust in favor of DSLC Capital Corp.

[3] This appeal proceeded as a hearing *de novo*. Two witnesses were called and cross-examined. They were John Lorenzo and Robert Carbonaro. As well, previous examinations and cross-examinations of individuals were received as their evidence on appeal. Those witnesses were David Carbonaro, Robert Carbonaro, John Lorenzo, Georges Bennaroch, Marjorie Ann Glover and Alistair Crawley. In addition, affidavits and supplementary affidavits of the same persons, as well as Charles B. Wagner, were received as evidence.

[4] I found the evidence of John Lorenzo and Robert Carbonaro to be believable. I found Mr. Lorenzo's evidence to be more helpful.

[5] Mr. Lorenzo's interest in this matter is relatively straightforward. He has a Master's degree in Economics and, since his graduation from the American University in Beirut, he has been an independent business person. He came to Canada in 1971 and he has been involved with a number of companies in Canada during his time here.

[6] Mr. Lorenzo formulated a business plan. He knew of several investors who resided outside of Canada and who were looking for a boutique investment advisor to provide them with personalized investment advisor services. He was looking for a fully-licensed vehicle so the advice could be legally given. The revenue stream of the vehicle was not important.

[7] Mr. Lorenzo was introduced to Georges Bennaroch by a friend, David Carbonaro, in 2007. Georges Bennaroch controlled Credifinance Securities Limited. After meeting with Georges Bennaroch on August 20, 2007, it appeared to Mr. Lorenzo that Credifinance Securities Limited was the vehicle he was looking for. The company had only a few retail accounts and it was in the process of winding them down. Georges Bennaroch indicated that he wished to move to Paris to be closer to his daughter who was studying there and was, therefore, willing to make Credifinance Securities Limited available to Mr. Lorenzo.

[8] The March 31, 2007 audited financial statements of Credifinance Securities Limited disclosed no significant contingent liabilities. Those audited financial statements made reference in a note to a decision of a hearing panel of the Investment Dealers Association ("IDA"), which found the company guilty of failing to provide information and documents and fined it $50,000, plus $15,000 costs. The note also informed the reader that, on July 15, 2007, an appeal panel of the IDA had reversed the conviction and fine.

[9] At some point, the IDA became the Investment Industry Regulatory Organization of Canada ("IIROC"). I will refer to the regulator as the IDA throughout.

[10] After reading the note, Mr. Lorenzo asked Georges Bennaroch about the IDA investigation and he was informed that the case was closed. This was not true. In fact, Georges Bennaroch, Ms. Ann Glover, the CFO of Credifinance Securities Limited, and Credifinance Securities Limited itself were still under investigation. Georges Bennaroch knew this because the IDA had written to Ms. Ann Glover on July 17 and 27, 2007 reminding her that it had previously informed her that it had commenced an investigation into Credifinance Securities Limited and Mr. Georges Bennaroch and asking for information. There was no dispute about the fact that Georges Bennaroch knew about the July correspondence. Accordingly, when Georges Bennaroch met with Mr. Lorenzo on August 20, 2007, he knew that the IDA investigation was continuing.

[11] Georges Bennaroch attempted to suggest, in his affidavit and cross-examination, that Mr. Lorenzo knew about the ongoing IDA investigation. Counsel for the Trustee also articulated this possibility, but not as an advocate for Georges Bennaroch.

[12] I completely reject this suggestion; it is simply unbelievable. I do not believe that Mr. Lorenzo would solicit the interest of friends in a licensed entity which was under investigation and could be publicly embarrassed by the laying of charges at any time. In addition, the deal made between Mr. Lorenzo and Georges Bennaroch allowed Georges Bennaroch to continue as Chairman of the board. It is not reasonable to believe that Mr. Lorenzo would have permitted Georges Bennaroch to remain associated with Credifinance Securities Limited if he had known that Georges Bennaroch was under investigation by the IDA and could be charged at any time. Charges against Credifinance Securities Limited, or its Chairman, would completely discredit the company in the eyes of potential investors and undermine Mr. Lorenzo's business plan.

[13] It was also suggested that David Carbonaro knew about the IDA investigation. It was suggested that another company, known as Foundations, did not purchase an interest in Credifinance Securities Limited due to the outstanding IDA investigation. It was suggested that Mr. Lorenzo knew this because he had invested $100,000 in Foundations and because his friend, David Carbonaro, was active in Foundations' affairs.

[14] Mr. Lorenzo testified that Foundations never completed its agreement with Credifinance Securities Limited because Foundations lost interest in the transaction after deciding that it did not need Credifinance Securities Limited. David Carbonaro was examined prior to this motion. He is a lawyer at Heenan Blaikie LLP. At one point, he acted for Georges Bennaroch. He is a friend of John Lorenzo and the brother of Robert Carbonaro. He testified that he was involved with the group at Foundations. He testified that the only investigation he knew about was the IDA charge, which had been successfully appealed. He said he would not have involved his brother and his friend, Mr. Lorenzo, in a matter that could have been problematic due to an ongoing securities regulator investigation.

[15] In addition, Credifinance Securities Limited was named in a lawsuit in the United States. This lawsuit, if successful, would have resulted in a significant judgment against Credifinance Securities Limited and other defendants. In such a case, Credifinance Securities Limited would have been compelled to rely upon an indemnity given to it by another one of the defendants in the lawsuit. This contingent liability was not disclosed in the audited financial statements of Credifinance Securities Limited. It is common ground that it was not disclosed to Mr. Lorenzo.

[16] Mr. Lorenzo had no reason to invest his money and time in a company that could be wiped out by an IDA investigation or a significant judgment in a U.S. lawsuit should its indemnity prove unenforceable. The only reason he did so was because he knew about neither.

[17] Unaware of the IDA investigation and unaware of the U.S. lawsuit, Mr. Lorenzo made a deal with Mr. Georges Bennaroch to invest in Credifinance Securities Limited. Mr. Lorenzo would arrange for a $400,000 loan to Credifinance Securities Limited to cure the fact that it was undercapitalized as far as the IDA was concerned. In addition, for a nominal sum of $1,000, it would receive 9.1% of the equity in Credifinance Securities Limited. The $400,000 loan was actually the first installment of a $2 million loan. In order to receive IDA approval of the transaction, it was necessary for the loan to be subordinated to the creditors of Credifinance Securities Limited. Mr. Lorenzo used DSL Capital Corp. as the corporate vehicle for this transaction.

[18] According to Mr. Lorenzo, the $400,000 was to be kept in a segregated account. It was not to be used to fund operating expenses. Operating expenses were to be paid by means of a $50,000 per month payment. Mr. Lorenzo was to arrange $25,000 per month and Georges Bennaroch was to arrange $25,000 per month.

[19] Georges Bennaroch did not prove to be helpful to Mr. Lorenzo in his efforts to implement his business plan and so a second deal was made, whereby Mr. Lorenzo would end up owning approximately 80% of Credifinance Securities Limited. This transaction failed to close because Georges Bennaroch was charged by the IDA.

[20] Initially, the $400,000 was kept in a segregated account. However, after the second share purchase agreement collapsed due to the IDA charges, the $400,000 was used to pay expenses until Mr. Justice Cameron made an order, on April 20, 2009, that the remaining funds ($310,500) were to be paid into court pending the ultimate disposition of an application by DSLC Capital Corp. for relief against Georges Bennaroch and Credifinance Securities Ltd., Donabo Inc. (the corporate vehicle of Georges Bennaroch), Ms. Ann Glover and Credifinance Capital Corp.

[21] The test for civil fraud is that stated by Lord Herschell in *Derry v. Peek* (1889), 14 A.C. 337 (H.L.) at 374:

> ...fraud is proved when it is shewn that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states…if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.

[22] I am satisfied, on a balance of probabilities, that Mr. Lorenzo was deceived by Georges Bennaroch. Specifically, the deceit was that there were no contingent liabilities when, to Georges Benarroch's knowledge, there was an outstanding IDA investigation which could potentially result in charges against Credifinance Securities Limited, as well as himself and the CFO of Credifinance Securities Limited, Ms Ann Glover. In addition, there was an outstanding U.S. lawsuit in which the plaintiffs were seeking millions of dollars from the defendants, one of which was Credifinance Securities Limited.

[23] I am also satisfied, on a balance of probabilities, that, but for the deceit, Mr. Lorenzo would not have entered into any agreement concerning Credifinance Securities Limited, would not have lent Credifinance Securities Limited $400,000, and Credifinance would not have $310,500 in its bank account.

[24] At present, it appears that Georges Bennaroch and a company he controls, Credifinance Capital Corp., have filed secured claims in the bankruptcy of Credifinance Securities Limited. It appears that the other creditors are lawyers who acted for Credifinance Securities Limited in the

litigation against DSLC Capital Corp and its attempts to recover the $400,000 and in the IDA investigations. In this regard, it is also a fact that Georges Bennaroch, through his company, Donabo Inc., has guaranteed the fees of the Trustee.

[25] Counsel for the Trustee takes the position that, even if there was a fraudulent misrepresentation, it would not allow DSLC Capital Corp. to bypass the *Bankruptcy and Insolvency Act*. Counsel takes the position, on behalf of the Trustee, that there is no special status accorded to the victim of a fraud. In addition, the Trustee takes the position that DSLC Capital Corp.'s $400,000 loan was subordinated to creditors of Credifinance Securities Limited and, therefore, DSLC Capital Corp. sits behind the interests of genuine creditors of Credifinance Securities Limited.

[26] Counsel for the Trustee concedes that there is an exception when constructive trust principles are applied, but suggests that those principles are applied only in the most extraordinary cases. Counsel suggested that the case of *Re Ascent Ltd* (2006), 18 C.B.R. (5th) 269 (S.C.J.) was such a case. In that case, a judge of this Court had ordered that funds were to be set aside pending a further order of the Court. That order was breached with the result that the funds ordered set aside and held in trust were available to creditors of the bankrupt. In those extraordinary circumstances, the Court imposed a constructive trust on those funds on the theory that, to permit the creditors access to the money, would result in them being unjustly enriched.

[27] Counsel for the Trustee also takes the position that a constructive trust cannot apply to a contract claim. I was referred to the cases of *Pikalo v. Morewood Industries Ltd.,* 1991 CarswellOnt 212, a decision of this Court for that proposition and, as well, the case of *Confederation Life Insurance Company v. Waselenak,* 1997 CarswellAlta 1032, a decision of the Alberta Court of Queen's Bench.

[28] I do not read the decision of Mr. Justice Chadwick, in the *Pikalo v. Morewood* case, as standing for that proposition. In that case, the lessor entered into a written lease agreement with Morewood Homes. The lease was with reference to a parcel of land on which there were two model homes. The lease provided that Morewood Homes would have the option to exchange either model and replace it with another pre-constructed home. If Morewood Homes exercised its right in this regard, the lessor was required to pay $48,000 toward the cost of constructing the new model home. Morewood Homes exercised its right and the lessor paid it $48,000. Morewood Homes paid the $48,000 to Morewood Industries Ltd. However, Morewood Industries Ltd. was petitioned into bankruptcy and could not replace the model home which had been removed.

[29] Mr. Justice Chadwick found that the relationship between the parties was purely contractual. He found that there was no evidence of bad faith on the part of anyone. Because the relationship was purely contractual, Chadwick J. came to the conclusion that it was not appropriate to impose a constructive trust upon certain monies in Morewood Industries Ltd.'s bank account. I did not read the decision as laying down a general rule that there can never be a constructive trust ordered where the contract has been entered into as a result of a fraud.

[30] In *Confederation Life Insurance Company v. Waselenak, supra,* the defendant received disability payments from the plaintiff and failed to account to the plaintiff for disability payments which the defendant received from the Workers Compensation Board. The Court ruled that the defendant's bankruptcy did not relieve the defendant of its obligation to repay the plaintiff. It declined in those circumstances to place a constructive trust upon assets of the defendant because it was of the view that the relationship between the plaintiff and the defendant was purely contractual. Once again, there was no suggestion that the contract of insurance was entered into as a result of a fraud. Rather, the contract was entered into in good faith and simply breached.

[31] The $400,000 payment was characterized by the parties to the subordination agreement as a loan. However, the IDA cancelled the loan April 1, 2009 months before the assignment (August 24, 2009). Trying to characterize the "loan" as equity is at odds with the subordination agreement, the fact that it was not convertible, the multiple references to debt in the documents and the provision for interest. In addition, there was a subscription agreement signed in November, 2007, whereby DSLC Capital Corp. subscribed to 9.1% of the equity for $1,000. I am not persuaded that the $400,000 was other than what Mr. Lorenzo said it was: namely, the first installment of a $2 million loan.

[32] A court of equity will impose a constructive trust to permit a fraud victim to recover property lost as a result of the fraud, provided the property is traceable in equity. See: *Underhill's Law Relating to Trusts and Trustees* (12th ed.) 1979, at p. 243; *Holmes v. Almez International Inc.* 2009 CarswellOnt 6595 at para. 7; *Goodbody v. Bank of Montreal*; *Goodbody v. Lester* (1974), 47 D.L.R. (3d) 335 (Ont. H.C.); and *Ontario (Securities Commission) v. Greymac Credit Corp.*, 55 O.R. (2d) 673 (C.A.)

[33] I am satisfied that the $400,000 invested by Mr. Lorenzo, through DSLC Capital Corp., is traceable to the $310,500. The finding of Mr. Justice Cameron in this regard is set out at para. 78 of his decision. His decision in that regard has not been successfully appealed. The evidence before me does not suggest any conclusion other than the fact that the $310,500 is traceable to the $400,000 provided to Credifinance Securities Limited by DSLC Capital Corp.

[34] Accordingly, I am satisfied that the only reason Credifinance Securities Limited is in possession of $310,500 is due to the fraud perpetrated on Mr. Lorenzo and DSLC Capital Corp. by Georges Bennaroch. I am satisfied that the $310,500 is traceable to the $400,000 provided by Mr. Lorenzo and DSLC Capital Corp. I am satisfied that those funds should be the subject of a constructive trust in favor of DSLC Capital Corp. in order to prevent the unjust enrichment of Credifinance Securities Limited.

[35] Having regard to the fact that the effect of my ruling means that the Estate of Credifinance Securities Limited has virtually no assets, there will be no order concerning costs.

MARROCCO J.

DATE: 20100216

TAB 5

Re Ontario Securities Commission and Greymac Credit Corp.

51 O.R. (2d) 212

ONTARIO
HIGH COURT OF JUSTICE
PARKER A.C.J.H.C.
17TH APRIL 1985.

Trusts and trustees -- Existence of trust -- Mortgagee syndicating mortgage among participants -- Agreement providing that mortgagee held land in trust for participants -- Proceeds of sale of property held on express trust for participants.

Trusts and trustees -- Breach of trust -- Tracing -- Mingled bank account -- Rule in Clayton's Case not applying when allocating losses and distributing trust funds between innocent beneficiaries -- General tracing rule applicable.

In 1979 the respondent took a first mortgage for $2,125,000 from A Ltd. The mortgage was syndicated to a number of investors (the "participants") and the respondent, the former providing $1,952,685.26 and the latter $172,314.74 of the mortgage funds. Under the participation agreement, the respondent held the mortgaged property as trustee for the participants to the extent of their participation in the loan. The mortgagor defaulted in 1980 and the respondent instituted power of sale proceedings. Certain liens and certificates of action having been filed, these were vacated after the deposit of a letter of credit from a bank in the amount of $1,013,600. The letter of credit was secured by a term deposit in the same amount made by the respondent at the bank. The property was sold in 1980 for $2,101,339. The proceeds were distributed in part, but the respondent was then still owed $117,314.74 and the participants $841,285.26, for a total of $1,013,600, the latter sum being the amount of the term deposit. The respondent informed the participants that they would receive interest on their portion of the term deposit and interest was paid to them monthly until December, 1982. In November, 1982, the letter of credit was cancelled and on December 15th, the respondent cashed the term deposit and placed the proceeds in its savings account at the bank. That account then had a balance of $3,000 in it. On the same day the respondent drew a cheque in the amount of the term deposit and deposited it in the G. Trust Co. general account (the "mingled account") to the credit of the respondent. At that time, the latter account had a balance in it of $4,683,000, the beneficial ownership of it being in C. Trust Co., G. Trust Co. and S. Trust Co. (collectively referred to as the "trust companies").

On December 17, 1982, $8,773,000 was received from the sale of Canada Treasury Bonds and deposited into the mingled account. On the same day, $8,774,000 was transferred from that account to G. Trust Co. and another cheque for $4,000,000 was drawn in favour of C. Trust Co. and deposited in the C. Trust Co. savings account, a newly-opened account (the "separate account"), to the credit of the respondent, where it still remains. It was not established whether the deposit of $8,773,000 consisted of the funds of the respondent or of the trust companies. Nor was it established whether the $8,774,000 went to the trust companies as beneficiaries or as creditors. The sequential order of these transactions was also not established.

Between December 21 and December 23, 1982, $393,000 was dissipated from the mingled account. On December 24th, a further $390,000 was dissipated, $976,000 was received from the sale of Canada Treasury Bonds and deposited into the mingled account and $975,000 was transferred from the mingled account to C. Trust Co. The sequential order of these transactions was not established. By January, 1983, a further $557,000 was dissipated from the mingled account.

In the result, the respondent, the participants and the trust companies had deposited $172,314.74, $841,285.26 and

$4,683,000, respectively, for a total of $5,696,600 in the mingled account. According to affidavit evidence, the funds dissipated from that account amounted to $1,340,000. However, the amount remaining in the account as of June 4, 1984, was $353,408.66 and the amount remaining in the separate account on that date was $4,000,000 for a total of $4,353,408.66. Hence, a further $3,191.34 had disappeared. In the result, the real shortfall between the claims of the respondent, the participants and the trust companies and the funds remaining in the two accounts was $1,343,191.34.

An application was brought for directions as to the disposition of the $353,488.66 remaining to the credit of the respondent in the mingled account and of the $4,000 remaining to its credit in the separate account.

Held, the rule in Clayton's Case does not apply to allocate losses and distribute trust funds between innocent beneficiaries. Instead, the losses should be allocated in proportion to the beneficiaries' traceable interests in the accounts.

(1) The proceeds of sale of the mortgaged property of $2,101,339 were held by the respondent on an express trust for all the participants to the extent of their participation in the mortgage loan.

(2) The rule in Clayton's Case provides that with respect to a current account containing mingled funds, in the absence of a specific intention on the part of the account-holder to appropriate a specific disbursement to a specific deposit, the court will allocate the disbursements between the depositors on the basis of the first-in-first-out rule. The rule has been applied to trustee account-holders. The rule in Re Hallett's Estate is an exception to it and holds that where the funds of the trustee account-holder are mingled, disbursements will be deemed to have been made first out of the trustee's funds and only when those have been exhausted, out of trust funds belonging to the beneficiaries. As between the beneficiaries, allocation of losses will then be made on the basis of the rule in Clayton's Case. The rules are not designed to create

interests in funds, but to allocate losses. Until there are losses, the rules do not apply and the beneficiaries, if more than one, are entitled to trace the moneys into their product and they have an equal equity, each being entitled to a charge on the product and the charges rank pari passu according to their respective amounts. Hence, at the time the separate account was opened, the trustee and beneficiaries had an interest in the mingled account proportionate to their respective traceable contributions to it, because at that time, no losses had been sustained. It follows that they also had similar interests in the separate account. The beneficiaries would rank ahead of the trustee with respect to both accounts. As between the two innocent beneficiaries at that time, they ranked equally in their claims to both accounts to the extent of their respective traceable contributions to the mingled fund. The trustee's, participants' and trust companies' respective traceable interest in the separate account should be allocated accordingly, whether or not the rule in Clayton's Case applies to allocate subsequent losses to the mingled account. However, because the beneficiaries rank ahead of the trustee, the trustee's interest in the separate account can be affected by disbursements out of the mingled account after the opening of the separate account and should be shared rateably between the beneficiaries.

(3) The application of the rule in Clayton's Case is unfair and illogical when allocating losses and distributing trust funds between innocent beneficiaries. The rule arose out of the debtor-creditor relationship and should be restricted to that relationship. The general rules of tracing are adequate to deal with the problem of allocating losses to a mingled fund held by a trustee.

(4) In the result, when the separate account was opened, total deposits of $5,696,000 had been made to the mingled account, the respective traceable contributions being $4,683,000 for the trust companies, $841,285.26 for the participants and $172,314.74 for the respondent trustee. These parties each had an interest in the account proportionate to their respective traceable contributions to it. They had similar interests in the separate account when it was opened.

However, the trustee's interest in this account was subject to any outstanding claims to the mingled fund. The $8,773,000 deposit and the $8,774,000 disbursement could be ignored, since they did not affect the proportionate relationship of the traceable interests in the mingled account. The same applies to the $976,000 deposit and the $975,000 disbursement. Moreover, it must be assumed that it was the trustee's intention to allocate the disbursements against the deposits so as not to affect the proportionate relationship of the various interests.

The losses from the mingled fund, namely, $393,000, $390,000, $557,000 and $3,191.34, for a total of $1,343,191.34, had first to be allocated against the trustee's interests and, since they exceeded the trustee's interests in both accounts, the trustee's interests were reduced to zero. Of the balance of $353,408.66 remaining in the mingled account, on a proportionate basis, the trust companies and the participants were, therefore, respectively entitled to $299,588.58 and $53,820.08. They were entitled to share on the same basis in the moneys in the separate account, including the trustee's interest in that account.

Gibbs v. Gerberich (1964), 203 N.E. 2d 851, folld

Sinclair v. Brougham, [1914] A.C. 398, discd

Re Walter J. Schmidt & Co. (1923), 298 Fed. 314, consd

Clayton's Case (1816), 1 Mer. 572, 35 E.R. 781; Re Hallett's Estate (1879), 13 Ch. D. 696; Re Oatway; Hertslet v. Oatway, [1903] 2 Ch. 356; Re Diplock; Diplock v. Wintle, [1948] Ch. 465; affd [1951] A.C. 251 sub nom. Ministry of Health v. Simpson; Re Law Society of Upper Canada and Riviera Motel (Kitchener) Ltd. et al. (1981), 33 O.R. (2d) 65, 123 D.L.R. (3d) 409, 9 E.T.R. 188 sub nom. Re Delaney; Pennell v. Deffell (1853), 4 De G. M. & G. 372, 43 E.R. 551; Bailey v. Jellett et al. (1884), 9 O.A.R. 187; James Roscoe (Bolton), Ltd. v. Winder, [1915] 1 Ch. 62; Corbett et al. v. McKee, Calabrese & Whitehead et al. (1984), 16 E.T.R. 200, not folld

Other cases referred to

Sleech's Case (1816), 1 Mer. 539, 35 E.R. 771; Cory Bros. & Co. Ltd. v. Owners of Turkish Steamship "Mecca", [1897] A.C. 286; Henniker v. Wigg (1841), 4 Q.B. 791, 114 E.R. 1095; City Discount Co., Ltd. v. McLean (1874), L.R. 9 C.P. 692; Hancock v. Smith (1889), 41 Ch. D. 456; Re Stenning; Wood v. Stenning, [1895] 2 Ch. 433; Mutton v. Peat, [1899] 2 Ch. 556; British Canadian Securities Ltd. v. Martin et al., [1917] 1 W.W.R. 1313, 27 Man. R. 423; Re Coville Transport Co. Ltd. (1947), 28 C.B.R. 262; Re C.A. Macdonald & Co. Ltd. (1958), 17 D.L.R. (3d) 416, 26 W.W.R. 116, 37 C.B.R. 119; revd on other grounds 18 D.L.R. (2d) 731, 28 W.W.R. 231

APPLICATION for directions as to the disposition of moneys remaining to the credit of the respondent in two trust company accounts.

Brian P. Bellmore, for applicant.

Barry S. Wortzman, Q.C., and Charles U. Simco, for Standard Trust Co., receiver and manager of Greymac Mortgage Corporation.

W. V. Sasso, for Greymac Trust, Crown Trust and Seaway Trust.

C. Clifford Lax, Q.C., for individual syndicated investors.

PARKER A.C.J.H.C.:--

Introduction

This was originally an application by Coopers & Lybrand Limited, the receiver and manager of the respondent Greymac Credit Corporation (hereinafter "Credit") for an order directing the trial of an issue in respect of:

(a) the liability, if any, of Greymac Credit Corporation to the Participants in a syndicated mortgage loan known as the Chorny mortgage;

(b) the liability, if any, of Greymac Credit Corporation to Greymac Mortgage Corporation in respect of the aforesaid mortgage loan; and

(c) in the event that Greymac Credit Corporation is held to be liable under either (a) or (b) above, the priority, if any, of the claims of the aforesaid Participants or Greymac Mortgage Corporation in relation to the claims of other creditors of Greymac Credit Corporation.

On the hearing of the application, counsel were agreed as to the facts and, hence, the application has, in effect, become one for directions as to the disposition of $353,408.66 remaining to the credit of Credit at Greymac Trust Company (hereinafter "Greymac") in general account No. 1808648-500 (hereinafter the "Greymac Trust General Account"), and of $4,000,000 remaining to the credit of Credit at Crown Trust Company (hereinafter "Crown"), in a savings account (hereinafter the "Crown Trust Savings Account"). The third account that will be referred to is savings account No. 1795152 at the Royal Bank of Canada held in the name of Credit (hereinafter the "Royal Bank Savings Account").

The dispute is essentially between Credit, a number of investor participants (hereinafter the "Participants") in a syndicated mortgage between Credit and Altai Developments Limited (hereinafter the "Chorny Mortgage"), and three trust companies, Crown, Greymac and Seaway Trust Company, which trust companies will hereinafter be referred to collectively as the "companies".

Issues

The central problem in this case involves the tracing of trust funds through three accounts which contained the mingled funds of the trustee (Credit) and two sets of beneficiaries (the Participants and the companies). The problem is complicated by the fact that a part of the mingled funds has been dissipated so that the disposition of the remaining mingled funds necessarily involves an allocation of the losses among the claimants. The central problem of tracing raises two issues:

(1) Does the rule in Clayton's Case (1816), 1 Mer. 572, 35 E.R. 781, apply so as to determine the allocation of losses to a general, savings, current, bank or trust account in which the funds of a trustee and his beneficiaries have been wrongfully mingled? If the rule in Clayton's Case does not apply, what rule does apply to determine the allocation of such losses?

(2) What is the effect upon that allocation of losses when a trustee withdraws part of the mingled funds and places it in a separate account to his own credit?

Facts

Before dealing with the issues, I will briefly state the facts of the case. In April, 1979, Credit took a first mortgage in the amount of $2,125,000 from Altai Developments Limited. This Chorny Mortgage was syndicated to the Participants. The Participants provided $1,952,685.26, and Credit provided $172,314,74 of the mortgage funds. The participation agreement stated that Credit held the mortgaged property as trustee for all the Participants to the extent of their participation in the loan, thereby creating an express trust in the land. In 1980, the mortgagor defaulted and Credit instituted power of sale proceedings. Certain liens and certificates of action were then registered. Master Sandler vacated the liens on May 15, 1980, subject to the filing of a letter of credit. On May 22, 1980, a letter of credit from the Royal Bank in the amount of $1,013,600 was filed. The letter of credit was secured by a term deposit in the amount of $1,013,600 made by Credit at the Royal Bank.

In June, 1980, the mortgaged property was sold for $2,101,339. I find that Credit held this money on an express trust for all the Participants to the extent of their participation in the loan. After a partial distribution of the proceeds, Credit was still owed its $172,314.74, and the

Participants were still owed $841,285.26, a total of $1,013,600, the amount of the term deposit securing the letter of credit. Indeed, by letter dated June 6, 1980, Credit informed the Participants that the latter would receive interest with respect to their portion of the term deposit, which interest was remitted pro rata to the Participants on a monthly basis until December, 1982.

On November 10, 1982, minutes of settlement were executed which resulted in the dismissal of the lien actions and a cancellation of the letter of credit. On December 15, 1982, the term deposit at the Royal Bank which had secured the letter of credit was cashed and the $1,013,600 proceeds were deposited in the Royal Bank Savings Account in the name of Credit. This account already had a balance of $3,000 in it. On the same day, Credit drew on this account a cheque in favour of itself in the same amount, $1,013,600, the cheque voucher and cheque requisition notation stating "Re: Transfer of Funds Royal Bank Term Deposit." On the same day -- December 15, 1982, Credit then deposited this cheque into the Greymac Trust General Account in the name of Credit.

At the time the $1,013,600 cheque was deposited into the Greymac Trust General Account, that account had a balance in it of $4,683,000, the beneficial ownership of which, I find, rested with the companies. The addition of the $1,013,600 brought the balance in the Greymac Trust General Account on December 15, 1982, to $5,696,600. I find as a fact that these funds belonged to the trustee, Credit, in the amount of $172,314.74, and to two sets of beneficiaries, the Participants and the companies, in the amounts of $841,285.26 and $4,683,000 respectively.

On December 17, 1982, a number of transactions took place. As stated in the affidavit of Mr. Richard C. Pettit, dated December 21, 1984, the sequential order of these transactions could not be established.

On December 17, 1982, $8,773,000 was received from McLeod Young Weir Limited from the sale of Canada Treasury Bonds and deposited in the Greymac Trust General Account. On the same day, $8,774,000 was transferred from that account to Greymac. It was not established by affidavit evidence, nor were counsel agreed, as to whether the $8,773,000 deposit consisted of the funds of the trustee, Credit, or of the companies, nor was it established or agreed whether the $8,774,000 disbursement went to the companies as beneficiaries or creditors. On December 17, 1982, a $4,000,000 cheque was drawn in favour of Crown and deposited by Crown in the Crown Trust Savings Account, in the name of Credit, where it remains today.

Between December 21 and 23, 1982, $393,000 was dissipated from the Greymac Trust General Account. On December 24, 1982, three transactions occurred. The sequential order of the transactions was not established in evidence and I must assume is unknown. A further $390,000 was dissipated. $976,000 was received from McLeod Young Weir Limited from the sale of Canada Treasury Bonds and deposited in the Greymac Trust General Account. $975,000 was transferred from that account to Crown. It was not established by affidavit evidence, nor were counsel agreed, as to whether the $976,000 deposit consisted of the funds of the trustee, Credit, or of the companies, nor was it established or agreed whether the $975,000 disbursement went to the companies as beneficiaries or creditors.

By January, 1983, a further $557,000 was dissipated from the Greymac Trust General Account.

Credit, the Participants and the companies have deposited $172,314.74, $841,285.26, and $4,683,000 respectively, or a total of $5,696,600 in the Greymac Trust General Account. On the face of the affidavit, the funds dissipated from the Greymac Trust General Account amount to $1,340,000. In fact, the amount remaining in the Greymac Trust General Account, according to para. 20 of Mr. Pettit's affidavit of June 4, 1984, is $353,408.66, and the amount remaining in the Crown Trust Savings Account is $4,000,000, for a total of $4,353,408.66. That is, a further $3,191.34 has disappeared. Hence, the real shortfall between the claims of Credit, the Participants and the companies, and the funds remaining in the two accounts, is $1,343,191.34, and therein lies the dispute. It is agreed that no one else has a claim to the funds.

Counsel's arguments

Mr. Lax, Q.C., counsel for the Participants, and Mr. Sasso, counsel for the companies, argue respectively that the Greymac Trust General Account constitutes an "active bank account" or an "active unbroken account", and that therefore the rule in Clayton's Case applies. The rule in Clayton's Case, briefly stated, is that with respect to a current account containing mingled funds, in the absence of a specific intention on the part of the trustee account-holder to appropriate a specific disbursement to a specific deposit, the court will allocate the disbursements between the beneficiaries on the basis of the "first-in-first-out rule", that is, on the basis of a legal presumption which deems the first disbursements to have been made out of the first funds deposited. The exception to the rule, as stated in Re Hallett's Estate (1879), 13 Ch. D. 696, is that, where the funds of the trustee account-holder and beneficiaries are mingled, disbursements will be deemed to have been made first out of the funds of the trustee, and only when those funds have been exhausted, out of the trust funds belonging to the beneficiaries. As between the beneficiaries, allocation of losses will then be made on the basis of the rule in Clayton's Case.

Mr. Lax argues that the first deposit consisted of $4,683,000 belonging to the companies, and that the second deposit consisted of $1,013,600 belonging to the trustee and the Participants.

With respect to the deposits of $8,773,000 and $976,000, these deposits belonged either to the trustee or to the companies. If these deposits belonged to the trustee, the Re Hallett's Estate exception would apply. Hence, the $172,314.74, $8,773,000 and $976,000 of the trustee's funds would all be exhausted first to meet the disbursements from the mingled fund. The last deposit would be the $1,013,600 belonging to the Participants. Hence the shortfall to the mingled fund would be deemed to have fallen first on the shoulders of the trustee. The remaining shortfall would then be deemed to have fallen on the shoulders of the companies. In other words, the

Participants would rank ahead of the companies in a claim to the funds remaining in the account.

If the $8,773,000 and $976,000 deposits were trust funds which belonged to the companies, as Mr. Sasso argues, the disbursements of $8,774,000 and $975,000 to the companies would obviously come out of the companies' share of the mingled funds. Since the disbursements could have come out of any of the companies' funds, that is, the $4,683,000, $8,773,000 or $976,000, the rule in Clayton's Case would apply because, as Mr. Sasso argues, no intention on the part of the trustee to allocate the $8,774,000 disbursement to the $8,773,000 deposit, and the $975,000 disbursement to the $976,000 deposit, existed. The rule in Clayton's Case would deem the disbursements to the companies to have been made out of the companies' funds in order of date of deposit so that any funds remaining in the account would be deemed to have been deposited in the account on December 17, 1982, and December 24, 1982, that is, after the Participants' funds were deposited. The shortfall to the mingled funds would be deemed to have fallen first on the shoulders of the trustee, then on the shoulders of the Participants, and only the remainder on the shoulders of the companies. In other words, the companies would rank ahead of the Participants in a claim to the funds remaining in the account.

Mr. Lax seeks to avoid this result by responding that the deposit and disbursement of almost identical amounts on the same day indicated an intention on the part of the trustee to make the $8,774,000 disbursement out of the $8,773,000 deposit (both occurring on December 17, 1982), and the $975,000 disbursement out of the $976,000 deposit (both occurring on December 21, 1982). In that case, the last deposit would still be the $1,013,600, and the Participants would still rank ahead of the companies.

As to the $4,000,000 transferred into the Crown Trust Savings Account, Mr. Sasso argues that the $4,000,000 transaction does not constitute the purchase of a new asset but rather a disbursement out of a current account. He further argues that, since the rule in Clayton's Case deems it to have been made out of the first deposit, that is, the $4,683,000 belonging to the companies, therefore the funds, or anything purchased with them, must belong to the companies. No authority was cited for this argument. Implicit in this conclusion is the following logic: Had the $4,000,000 been dissipated, the companies alone would have borne the loss (ignoring for the moment any later deposits). Therefore, only the companies should be able to claim an interest in the funds which, by good fortune alone, were not dissipated.

Mr. Lax's argument with respect to the $4,000,000 is twofold. First, in oral argument, he argues that to move $4,000,000 from one account to another does not constitute a disbursement. The thrust of his argument is that the $4,000,000 transaction should be ignored and that, in effect, the $4,000,000 should be put back into the Greymac Trust General Account, so that the Participants would rank ahead of the companies in a claim to a $4,353,408.66 fund. In reality, what he asks the court to do is, first, to allow the Participants to trace their funds into the Crown Trust Savings Account, and, second, to transfer any priority of claims established by the rule in Clayton's Case with respect to the $353,408.66 remaining in the Greymac Trust General Account over to the $4,000,000 in the Crown Trust Savings Account. No authority was cited for this transfer of priorities.

Second, Mr. Lax argues, in the alternative, that the $4,000,000 in the Crown Trust Savings Account really constitutes a new asset purchased with mingled funds, so that the Participants can trace their funds into that asset. In other words, at the time the asset was purchased, no losses had yet been sustained in the Greymac Trust General Account. Hence, the Participants would be entitled to trace their funds into the new asset and to claim a proportionate share in the $4,000,000, in addition to any right they might have to claim the remaining funds in the Greymac Trust General Account.

The law

A. The effect upon the allocation of losses when a trustee withdraws part of the mingled funds and places it in a separate account to his own credit

It is a function of the uneasy coexistence between the rule in Clayton's Case and the rules of tracing that counsel can argue for a transfer of priorities which would retroactively transform interests which rank equally in relation to a separate account into interests which rank in an order of priority, or which would retroactively eliminate interests in a separate account altogether.

At the time the $4,000,000 was disbursed and put in the separate account, no losses had yet been sustained in the Greymac Trust General Account. All that existed was a mingled fund, the Greymac Trust General Account, and a separate account, the Crown Trust Savings Account, which account contained funds disbursed from the mingled fund.

It is trite law that, at that time, the Participants and the companies could have traced their funds into both the mingled fund and the separate account. In Re Hallett's Estate, Jessel M.R. stated at p. 719:

> But so long as the trust property can be traced and followed into other property into which it has been converted that remains subject to the trust.

Furthermore, Joyce J. stated in Re Oatway; Hertslet v. Oatway, [1903] 2 Ch. 356 at pp. 359-60:

> Trust money may be followed into land or any other property in which it has been invested; and when a trustee has, in making any purchase or investment, applied trust money together with his own, the cestuis que trust are entitled to a charge on the property purchased for the amount of the trust money laid out in the purchase or investment.

Therefore, at the time the separate account was opened, both the Participants and the companies ranked ahead of the trustee in respect of claims to both the mingled fund and the separate account to the extent of their respective traceable interests in the mingled fund.

As to the relationship of the innocent beneficiaries one to the other, Lord Parker stated as follows in Sinclair v. Brougham, [1914] A.C. 398 at p. 442:

> Suppose the property is acquired by means of money, part of which belongs to one owner and part to another, the purchaser being in a fiduciary relationship to both. Clearly each owner has an equal equity. Each is entitled to a charge on the property for his own money, and neither can claim priority over the other. It follows that their charges must rank pari passu according to their respective amounts. Further, I think that as against the fiduciary agent they could by agreement claim to take the property itself, in which case they would become tenants in common in shares proportioned to amounts for which either could claim a charge.

That case involved the claims of the shareholders of a building society and the claims of bank customers or depositors who had deposited money with the building society. The mingled funds had been used to purchase assets, and the assets were insufficient to meet in full the competing claims. It was held that the depositors and shareholders ranked pari passu or equally, and that the assets ought to be apportioned between them rateably according to the capital amount contributed by each respectively.

In Re Diplock; Diplock v. Wintle, [1948] Ch. 465 (C.A.), the executors of a certain estate distributed a large part of the residue among 139 charities before the next of kin successfully challenged the validity of the original bequest. The distributed funds thus became trust funds. Lord Greene M.R., speaking for the court, reiterated the principles stated in Sinclair v. Brougham. With respect to the mingled fund, His Lordship stated at p. 539:

> Where the contest is between two claimants to a mixed fund made up entirely of moneys held on behalf of the two of them respectively and mixed together by the fiduciary agent, they share pari passu, each being innocent.

With respect to assets purchased from moneys from the mingled fund, His Lordship stated at p. 533:

> The first of Lord Parker's own two illustrations is the case where a person standing in a fiduciary relation to two different persons acquires property by means of a mixed fund of money part of which had belonged to one and part to the other. In such a case each has an equal equity. Each is entitled to a charge and neither is entitled to priority over the other. The explanation of this result lies in the fact that each has an equitable right of property and that right of property can be traced by each into the asset purchased.

and at p. 541, His Lordship quoted with approval Lord Parker's opinion, which opinion can be found, supra.

With respect to trust funds which were received by an innocent volunteer without notice, Lord Greene stated at p. 539:

> In the case, however, of a volunteer who takes without notice, e.g., by way of gift from the fiduciary agent, if there is no question of mixing, he holds the money on behalf of the true owner whose equitable right to the money still persists as against him. On the other hand, if the volunteer mixes the money with money of his own, or receives it mixed from the fiduciary agent, he must admit the claim of the true owner, but is not precluded from setting up his own claim in respect of the moneys of his own which have been contributed to the mixed fund. The result is that they share pari passu. It would be inequitable for the volunteer to claim priority for the reason that he is a volunteer: it would be equally inequitable for the true owner of the money to claim priority over the volunteer for the reason that the volunteer is innocent and cannot be said to act unconscionably if he claims equal treatment for himself. The mutual recognition of one another's rights is what equity insists upon as a condition of giving relief.

However, with respect to one of the charities, Dr. Barnardo's Homes, the trust moneys which were received were mixed with the charity's own moneys in a general current account. On December 14th, the charity deposited (STERLING)3,000 of trust moneys into the account, which account already contained (STERLING) 46,771 of charity moneys. The charity then dissipated (STERLING)22,194. Finally, on December 24th, a further (STERLING)39,341 were disbursed to purchase a funding loan. The Diplock claimants sought to claim (STERLING)3,000 out of the new asset. His Lordship stated at p. 553:

> Taking, therefore, the starting figure of 46,771l. 4s. 11d. and deducting from it the 22,194l. 7s. 1d. withdrawn which, on Clayton's Case must be regarded as charity money, there remained 24,576l. 17s. 10d. The result would be that the sum of 39,341l. 13s. 9d. must be regarded as having consisted, as to the first 24,576l. 17s. 10d. of charity money, as to the next 3,000l. of Diplock money, and as to the remainder, of charity money. On this basis the appellants would be entitled to a charge on the funding loan in respect of their claim to 3,000l.
>
> The above result would only follow if Clayton's Case applies.

The reasoning of the court is not entirely clear. If the rule in Clayton's Case applied to the bank account, then clearly the (STERLING)22,194 had to come out of the charity moneys. Equally true, any further disbursements would have had to come out of the funds in the account in order of date of deposit. Hence the first funds to be drawn upon would have been the (STERLING)24,576 of charity moneys remaining from the original deposit, then the (STERLING)3,000 of Diplock money, and finally any remaining charity moneys.

What is the situation where a new asset is purchased with mingled funds? The court seems to say that the rule in Clayton's Case would deem the first (STERLING)24,576 in the new asset to belong to the charity. In other words, the order of priorities established by the rule in Clayton's Case with respect to the allocation of losses from the mingled fund would be reversed with respect to the creation of interests in the new asset purchased with funds disbursed from the mingled funds. This reasoning lends support to Mr. Sasso's argument.

With the greatest respect, in my view, the error in the argument is that the court perceived the rule in Clayton's Case as being a rule developed to create interests in funds, whereas in fact it is a rule designed to allocate losses. Had no disbursements from the account occurred, it would seem from the general principles outlined at pp. 533 and 539 that the volunteer and beneficiaries would have ranked equally and shared pro rata. Why should the priorities change if the only disbursement is not a loss but the purchase of an asset? If only (STERLING)24,576 had been disbursed to purchase the asset, would the Diplock beneficiaries have thereby been excluded from claiming an interest in the asset purchased?

A similar problem arose in Re Oatway. In that case, a trustee mingled his own funds with trust funds in a bank account, withdrew some of the mingled funds to purchase an investment in his own name, and then proceeded to dissipate the rest of the fund. Joyce J. held at p. 360:

> If, then, the trustee pays in further sums, and from time to time draws out money by cheques, but leaves a balance to the credit of the account, it is settled that he is not entitled to have the rule in Clayton's Case applied so as to maintain that the sums which have been drawn out and paid away so as to be incapable of being recovered represented pro tanto the trust money, and that the balance remaining is not trust money, but represents only his own moneys paid into the account. Brown v. Adams [(1869), L.R. 4 Ch. 764] to the contrary ought not to be followed since the decision In re Hallett's Estate. It is, in my opinion, equally clear that when any of the money drawn out has been invested, and the investment remains in the name or under the control of the trustee, the rest of the balance having been afterwards dissipated by him, he cannot maintain that the investment which remains represents his own money alone, and that what has been spent and can no longer be traced and recovered was the money belonging to the trust. In other words, when the private money of the trustee and that which he held in a fiduciary capacity have been mixed in the same banking

account, from which various payments have from time to time been made, then, in order to determine to whom any remaining balance or any investment that may have been paid for out of the account ought to be deemed to belong, the trustee must be debited with all the sums that have been withdrawn and applied to his own use so as to be no longer recoverable, and the trust money in like manner be debited with any sums taken out and duly invested in the names of the proper trustees.

In other words, the exception in Re Hallett's Estate to the rule in Clayton's Case, which exception had been designed so as to allocate losses to the mingled fund first of all against the trustee's interest in that fund, could not be applied so as to create an interest, and indeed a priority interest, on the part of the trustee in the new asset. I do not see that the rule in Clayton's Case itself can effect any different result. Nor do I see how, because of subsequent disbursements from the Greymac Trust General Account, the rule in Clayton's Case can deem the Participants' prior interest in the Crown Trust Savings Account to be extinguished, and deem the whole of that account to now belong to the companies. Therefore, Mr. Sasso's argument must fail.

On the other hand, Mr. Lax argues that the $4,000,000 ought to be put back into the mingled fund. In reality, he asks the court to transfer priorities from the mingled fund to the separate account. The trustee and beneficiaries originally had an interest in the mingled fund proportionate to their respective traceable contributions to the fund. At the time the separate account was opened, the mingled fund had not yet sustained any losses. It seems to me that the trustees and beneficiaries therefore had an interest in the separate account proportionate to their respective traceable interests in the mingled fund at the date the $4,000,000 was disbursed from that fund and put into the separate account.

As between the trustee and the beneficiaries, it is my view that, at that time, both beneficiaries ranked ahead of the trustee in their claims to the separate account and the mingled fund to the extent of their respective traceable contributions to the mingled funds.

As between the two innocent beneficiaries, it is my view that, at that time, they ranked equally in their claims to the separate account and the mingled fund to the extent of their respective traceable contributions to the mingled fund.

If the rule in Clayton's Case does apply to allocate subsequent losses to the mingled fund, I do not see how a rule triggered by subsequent disbursements in an account can retroactively transform interests in a separate account from interests which ranked equally into interests which ranked in an order of priority.

Therefore, it is my view that whether or not the rule in Clayton's Case applies to allocate the losses sustained in the Greymac Trust General Account, nevertheless, the $4,000,000 in the Crown Trust Savings Account ought to be allocated in proportion to the trustee's, the companies' and the Participants' respective traceable interests in the Greymac Trust General Account at the date the $4,000,000 was disbursed. As between themselves, the beneficiaries of course rank equally. However, since the beneficiaries rank ahead of the trustee, the trustee's interest in the separate account, unlike the interests of the beneficiaries in that account, can be affected by disbursements out of the mingled fund which occurred subsequent to the opening of the separate account. It is also my view that that part of the trustee's interest which is required to satisfy the beneficiaries' outstanding claims must be shared rateably between the beneficiaries in proportion to each beneficiary's share of the losses.

B. The applicability of the rule in Clayton's Case in determining the allocation of losses to a bank account containing mingled funds

With respect to the funds remaining in the Greymac Trust General Account after the $4,000,000 disbursement took place, the application of the rule in Clayton's Case would result in the subsequent $1,343,191.34 in disbursements from the account being allocated in the following way. First, the disbursements would be allocated against the trustee's interest. After the trustee's funds were exhausted, the remaining loss would first be allocated against the interest of either one or the other of the two innocent beneficiaries, depending on the date of the deposits, until that beneficiary's funds were exhausted or the loss covered.

Such an allocation of losses and distribution of trust funds between innocent beneficiaries is, in my view, neither logical nor fair. Nor am I alone in my expression of consternation over such a result.

In Re Law Society of Upper Canada and Riviera Motel (Kitchener) Ltd. et al. (1981), 33 O.R. (2d) 65, 123 D.L.R. (3d) 409, 9 E.T.R. 188 sub nom. Re Delaney, a solicitor misappropriated his clients' trust funds. With respect to one of the accounts, the following transactions occurred. On June 30, 1980, the solicitor deposited into the account $69,000, representing the sale proceeds on the Hykawy's home. On July 4th, he issued a cheque for $53,983.44 to the Bank of Montreal to pay off a loan on behalf of the Hykawys, but the cheque never cleared. Also, by July 4th, he had made disbursements such that the balance in the account was $4,447.33. It is clear then that, in any event, the Hykawys could not have traced more than $4,447.33 to the account, absent a further deposit of the solicitor's money intended to reimburse the trust fund. On July 4th, the solicitor deposited $64,129.55 belonging to McIntosh. Upon further withdrawals being made, the balance in the fund on July 14th was $54,633.08. Counsel argued that the rule in Clayton's Case ought not to apply and that all former clients should be treated equally, sharing any available trust funds and having recourse to the Law Society's Compensation Fund for the deficiency. Counsel may have been unduly moved by the fact that the solicitors had issued a cheque to counsel's clients which, "by the vicissitudes of chance", had not been honoured on time. The most counsel's clients could have traced was a pro rata share to the extent of $4,447.33, not $69,000.

Nevertheless, counsel did argue against the application of the rule in Clayton's Case, the application of which would have eliminated completely his client's interest. My brother, Pennell J., made the following observation at p. 68: "True, of course, the operation of the rule may work some odd and harsh results." And at pp. 70-1:

> To use borrowed language, I find it difficult to resist the argument "that it would have been preferable, if, instead of juggling with the accidental time sequence of events, the court had proportioned the loss between the clients according to the amounts due them respectively": Waters, Law of Trusts in Canada (1974), p. 895.

In Re Walter J. Schmidt & Co. (1923), 298 Fed. 314 (D.C.N.Y.), a stockbroker deposited proceeds from the sale of his clients' securities into a bank account, made disbursements and went bankrupt. Though bound to follow contrary authority, Judge Learned Hand, at p. 316, made the following observations about the rule in Clayton's Case:

> The rule in Clayton's Case is to allocate the payments upon an account. Some rule had to be adopted, and though any presumption of intent was a fiction, priority in time was the most natural basis of allocation. It has no relevancy whatever to a case like this. Here two people are jointly interested in a fund held for them by a common trustee. There is no reason in law or justice why his depredations upon the fund should not be borne equally between them. To throw all the loss upon one, through the mere chance of his being earlier in time, is irrational and arbitrary, and is equally a fiction as the rule in Clayton's Case, supra. When the law adopts a fiction, it is, or at least it should be, for some purpose of justice. To adopt it here is to apportion a common misfortune through a test which has no relation whatever to the justice of the case ... Such a result, I submit with the utmost respect, can only come from a mechanical adherence to a rule which has no intelligible relation to the situation.

The rejection of the rule in Clayton's Case by the academic commentators has been no less vigorous. In Canada, Professor D. W. M. Waters, in his Law of Trusts, 2nd ed. (1984), stated at p. 1045:

> It is really a rule of convenience, and it has no particular

> relevance to the issues that are raised in a tracing action, but it has been invoked in that respect, and more so in Canada, it seems, than in England.

And at p. 1050: "As one might suppose, the operation of the rule is sufficiently formulaic that it works some odd and hardly justifiable results."

In England, Mr. D. A. McConville wrote in an article entitled "Tracing and the Rule in Clayton's Case", 79 L.Q. Rev. 388 (1963):

> The view is respectively [sic] put forward, however, that Clayton's Case ... is, indeed, totally irrelevant to the law of tracing. This conclusion is reached by recognizing a distinction in the position of a bank account depending on whether the relationship of banker and customer or that of trustee and beneficiary is involved. An examination of the cases shows that Clayton's Case is appropriate to the former relationship, but there is no reason why it should apply to the latter.

In the United States, Professor A. Scott wrote in an essay entitled "The Right to Follow Money Wrongfully Mingled with Other Money", 27 Harv. L. Rev. 125 (1913) at p. 130, note 15:

> This [the application of the Rule in Clayton's Case to a bank account containing the mingled funds of beneficiaries] seems erroneous on principle. It would seem that on the constructive trust theory the persons wronged should be treated as co-owners in proportion to the amounts contributed by them, and the loss resulting from any withdrawals, like the gain from a rise in value (Lord Provost v. Lord Advocate, 4 App. Cas. 823 (1879), should be shared by them pro rata. On the lien theory it would seem that the same result should follow.

Professor Scott also wrote in his Law of Trusts, 3rd ed. (1967), vol. 5, at pp. 3639-41:

> Where the money of several claimants is mingled, and

subsequently withdrawals are made by the wrongdoers from the mingled fund, there is a conflict of authority on the question of the rights of the several claimants. It seems clear on principle that they should be entitled to share pro rata both in the money withdrawn or its product and in that remaining. If the amount withdrawn is dissipated or cannot be traced, the claimants should share the balance remaining in proportion to their contributions. It has been so held in a number of cases.

. . . . .

This result [the application of the Rule in Clayton's Case to a bank account containing the mingled funds of beneficiaries] is so clearly arbitrary and unfair that one must suspect the soundness of the reasons upon which it is based; and, indeed, the only basis turns out to be the application of presumptions based on fictions.

In the annotation entitled "Distribution of Funds Where Funds of More Than One Trust Have Been Commingled by Trustee and Balance is Insufficient To Satisfy All Trust Claims", 17 A.L.R. (3d) 937, J. F. Ghent wrote at p. 939:

The second method is to pay the trust beneficiaries in the reverse order of their deposits into the commingled fund, until that fund is exhausted. This method, admittedly based on the fiction that the first money placed in the commingled fund was the first money withdrawn or dissipated by the trustee, has been subjected to severe criticism on the ground that the first-in-first-out fiction, designed to work out equity between a wrongdoing trustee and a single trust beneficiary, creates injustice when transplanted among equally innocent trust beneficiaries.

The third method, recognized by most authorities as a just solution to the problem, is to distribute the remaining balance among the trust beneficiaries according to their pro rata shares. Some of the cases applying this method have further held that the proportion to be distributed to the beneficiary of each trust under such circumstances is to be reduced by the amount of any withdrawals made after his trust fund was deposited in the trustee.

The National Conference of Commissioners on Uniform State Laws adopted the following rule with respect to withdrawals from mingled trust funds (Uniform Trusts Act, 1937, 7A U.L.A. at p. 457):

> Where a person who is a trustee of two or more trusts has mingled the funds of two or more trusts in the same aggregate of cash, or in the same bank or brokerage account or other investment, and a withdrawal is made therefrom by the trustee for his own benefit, or for the benefit of a third person not a beneficiary or creditor of one or more of the trusts, or for an unknown purpose, such a withdrawal shall be charged first to the amount of cash, credit, or other property of the trustee in the mingled fund, if any, and after the exhaustion of the trustee's cash, credit, or other property, then to the several trusts in proportion to their several interests in the cash, credit, or other property at the time of the withdrawal.

In their "Comment" on the Act, the commissioners stated at p. 441:

> The rule of "first in, first out", or Clayton's Case, has been usually applied to withdrawals by a trustee from a fund or account containing the assets of two or more trusts. The trustee, by a mere rule of thumb and not of logic, is deemed to have drawn out for his own purposes and stolen first the first money put into the account. A much fairer rule is that he be deemed to have stolen from the several trusts in proportion to the amount of cash or credit they had in the mingled fund at the time.

The Restatement of Trusts, 2d, s. 202, comment (n) reads:

> Where the trustee deposits in a single account funds held by him as trustee under different trusts, and subsequently wrongfully withdraws and dissipates a part of the deposit, the beneficiaries of the trusts are entitled to share the

balance of the deposit proportionately, regardless of the order in which the deposits were made.

Finally, the Restatement, Restitution, s. 213, reads:

S. 213. Mingling Money of Several Persons.

(1) Except as stated in Subsection (2), where a person wrongfully mingles money of two or more persons, each of them is entitled to share in the mingled fund or in property acquired with the fund, in such proportion as his money bore to the whole amount of the fund.

In comments to s-s. (1), the Restatement states that, absent further disbursements from the mingled fund, the two persons whose moneys were wrongfully mingled are each entitled in equity to claim a proportionate share of the mingled fund. If a disbursement is made to acquire property, each of the persons is entitled to share in the property so acquired in such proportion as his money bore to the whole amount of the fund. Comment (c) then reads:

c. Effect of withdrawals from mingled fund. Where a person wrongfully mingles money of two or more persons and subsequently wrongfully withdraws and dissipates a part of the money, the claimants are entitled to share the balance proportionately. This is true where the wrongdoer deposits the money of two or more persons in a single bank account and subsequently makes withdrawals which he dissipates. It is immaterial in what order the deposits were made, since there is no inference that the money first deposited is the money first withdrawn. The rule in Clayton's Case (see S. 211, Comment a) that withdrawals are presumed to be in the same order as that in which the deposits were made, has no application to this situation, where the intention of the wrongdoer in making withdrawals is immaterial ...

Where money of some claimants is deposited and withdrawals are made and subsequently deposits are made of the money of others, the amount to which the earlier claimants are entitled is reduced by such withdrawals.

Illustrations:

5. A wrongfully takes $5000 belonging to B and deposits it in a bank. A draws out and dissipates $2000. A deposits $5000 belonging to C in the same account. A draws out and dissipates $4000. Of the balance of $4000 B is entitled to three-eighths or $1500, and C is entitled to five-eighths or $2500.

6. The facts are as stated in Illustration 5, except that A subsequently deposits $5000 belonging to D, and subsequently draws out and dissipates $4500. Of the balance of $4500 B is entitled to three-eighteenths or $750, C is entitled to five-eighteenths or $1250, and D is entitled to ten-eighteenths or $2500.

With these comments in mind, I now propose to examine the origins of the rule in Clayton's Case, and in particular its application to mingled trust funds.

The facts in Clayton's Case were as follows. A banking partnership was formed between a number of persons, including Devaynes. In the ordinary course of the banking business, a passage-book would be opened by the bank and delivered to the customer, in which passage-book the bank was described as the debtor and the customer as the creditor. Clayton opened a bank account with the bank prior to Devaynes' death. At the time of Devaynes' death, the account had a positive balance, so that Clayton was a creditor of the bank. After Devaynes' death, the surviving partners continued to carry on business without changing the firm, but Devaynes' estate had no continuing share or interest in the business or its profits. Clayton continued to deal with the bank and to make deposits and disbursements from his account. Ultimately, the surviving partners went bankrupt, and Clayton argued that Devaynes' estate was still liable to him on the original debt.

At the date of Devaynes' death, the balance in the account was (STERLING)1,713. Initially, Clayton claimed (STERLING) 1,171, the amount of the original debt less dividends received after the bankruptcy. However, within a few days of Devaynes' death, Clayton had withdrawn (STERLING)1,260, yielding an outstanding balance of (STERLING)453. In consequence of the decision in Sleech's Case (1816), 1 Mer. 539, 35 E.R. 771, which was reported with Clayton's Case, it was conceded that Clayton could only claim (STERLING)453, less a proportionate share of the dividends.

After the balance dropped to (STERLING)453, Clayton continued to make deposits and disbursements. The former exceeded the latter, so that the balance never dropped below (STERLING)453, and at the date of bankruptcy the balance exceeded the original debt of (STERLING)1,713. The total amount of all disbursements from the account from the date of Devaynes' death to the date of bankruptcy exceeded (STERLING)1,713, the amount of the original debt.

The issue was whether or not the debt of the deceased partner was discharged where, subsequent to his death, the creditor had withdrawn from his account a sum which exceeded the original debt. In other words, could the original debt ever be fully discharged without the balance in the account declining to zero?

Sir William Grant M.R., at pp. 605-7 Mer., p. 792 E.R., considered the rules adopted from the civil law which applied to indefinite payments. Where a debtor owed more than one debt to a creditor, the debtor could at the time of the payment elect to which debt the payment was to be allocated or appropriated. If the debtor did not so elect, the creditor could at the time of payment elect to which debt the payment was to be allocated. (The time restriction on the creditor's election has since been changed by Cory Bros. & Co. Ltd. v. Owners of Turkish Steamship "Mecca", [1897] A.C. 286 at p. 294, per Lord MacNaghten.) If neither the debtor nor the creditor made an election, then the rule was as stated by the Master of the Rolls at pp. 605-9 Mer., pp. 792-3 E.R.:

> If neither applied the payment, the law made the appropriation according to certain rules of presumption, depending on the nature of the debts, or the priority in

which they were incurred. And, as it was the actual intention of the debtor that would, in the first instance, have governed; so it was his presumable intention that was first resorted to as the rule by which the application was to be determined. In the absence, therefore, of any express declaration by either, the inquiry was, what application would be most beneficial to the debtor. The payment was, consequently, applied to the most burthensome debt,--to one that carried interest, rather than to that which carried none,--to one secured by a penalty, rather than to that which rested on a simple stipulation;--and, if the debts were equal, then to that which had been first contracted.

. . . . .

But this is the case of a banking account, where all the sums paid in form one blended fund, the parts of which have no longer any distinct existence. Neither banker nor customer ever thinks of saying, this draft is to be placed to the account of the (STERLING)500 paid in on Monday, and this other to the account of the (STERLING)500 paid in on Tuesday. There is a fund of (STERLING)1000 to draw upon, and that is enough. In such a case, there is no room for any other appropriation than that which arises from the order in which the receipts and payments take place, and are carried into the account. Presumably, it is the sum first paid in, that is first drawn out. It is the first item on the debit side of the account, that is discharged, or reduced, by the first item on the credit side. The appropriation is made by the very act of setting the two items against each other. Upon that principle, all accounts current are settled, and particularly cash accounts. When there has been a continuation of dealings, in what way can it be ascertained whether the specific balance due on a given day has, or has not, been discharged, but by examining whether payments to the amount of that balance appear by the account to have been made? You are not to take the account backwards, and strike the balance at the head, instead of the foot, of it.

. . . . .

Mr. Clayton travels back into the account, till he finds a balance, for which Mr. Devaynes was responsible; and then he says,--"That is a sum which I have never drawn for. Though standing in the centre of the account, it is to be considered as set apart, and left untouched. Sums above it, and below it, have been drawn out; but none of my drafts ever reached or affected this remnant of the balance due to me at Mr. Devaynes's death." What boundary would there be to this method of remoulding an account? If the interest of the creditor required it, he might just as well go still further back, and arbitrarily single out any balance, as it stood at any time, and say, it is the identical balance of that day which still remains due to him.

Though the rule is framed at least in part in terms of the debtor's presumed intention, in fact, it is a rule of common sense derived from the very nature of the banker-customer relationship in a current account. What made the account "current" or "running" or "unbroken" was the fact that, as between debtor and creditor, there was a running balance against which indefinite payments were made.

Of course, where a contrary intention arose out of the debtor-creditor relationship, the rule in Clayton's Case did not apply, as in Henniker v. Wigg (1841), 4 Q.B. 791, 114 E.R. 1095, and City Discount Co., Ltd. v. McLean (1874), L.R. 9 C.P. 692, both of which involved secured debts, and in Cory Brothers, supra, which involved not a bank account, but a discreet series of transactions in relation to the supply of two ships.

Had the rule in Clayton's Case been restricted to the banker-customer relationship in a current account, I would have had no trouble distinguishing it from the case at bar. However, the rule has been greatly expanded.

In Pennell v. Deffell (1853), 4 De G. M. & G. 372, 43 E.R. 551, an official assignee in bankruptcy paid money received by him in his official capacity into two accounts kept in his own name. In the London account, the trustee first deposited over (STERLING)800 of his own money, and then a certain amount of trust moneys. He then disbursed (STERLING)796 for trust and private purposes. In the Bank of England account, (STERLING)648 of trust moneys were deposited, after which (STERLING)107 were disbursed by the trustee for private purposes. (STERLING)72 were put back in by the trustee, and then (STERLING)442 of trust moneys were deposited. Ultimately, the trustee disbursed for private purposes in excess of (STERLING)72.

As noted by Baggallay L.J. in Re Hallett's Estate (1879), 13 Ch. D. 696, the main issue in the case was whether or not, when a trustee mixes his own money and trust moneys in a simple bank account in his own name, the trust beneficiaries can trace their moneys into that account. The court held that they could.

However, in so doing, Lord Justice Knight Bruce stated, at p. 384:

> It may be, however, and as I think is true, that checks drawn by the trustee in a general manner upon the bank, would for every purpose be ascribed and affect the account in the mode explained and laid down by Sir W. Grant, in Clayton's case. The principles there stated would, I conceive, be applicable, notwithstanding the different nature and character of the sums forming together the balance due from the bank to the trustee, whatever the purposes and objects of the checks.

and Lord Justice Turner stated, at pp. 390-1:

> Then, can the circumstance of the account consisting of a continued series of monies paid in and drawn out alter the principle? It may indeed increase the difficulty of ascertaining what belongs to the trust, but I can see no possible ground on which it can affect the principle.
>
> We must see, however, whether the law does not furnish the means of meeting even the difficulty arising from such a continued series of monies paid in and drawn out. I think that it does. I take it to be now well settled, that monies drawn out on a banking account are to be applied to the earlier items on the opposite of the account. By every payment which he makes, the banker discharges so much of the

debt which he first contracted. (This principle is by no means limited to bankers, but is applicable to all accounts ...) If that debt arose from trust-monies paid in by the customer, so much of those trust-monies is paid off, and, unless otherwise invested, on account of the trust, falls into the customer's general estate and is lost to the trust, because it cannot be distinguished from the general estate of which it has become part. If, on the other hand, the earliest debt due from the banker arose from the customer's own monies paid in by him, that debt is pro tanto discharged, and the trust-monies subsequently paid in remain unaffected. The same principle runs through the whole account; each sum drawn out goes to discharge the earliest debt due from the banker which is remaining unpaid; and thus, when it is ascertained what monies have been paid in belonging to the trust, it becomes clear to what portion of the balance which remains the trust estate is entitled.

These are the principles which in my opinion--concurring fully in that of my learned brother--are to be applied to such a case as the present. They are plain and simple, and furnish, as it seems to me, a ready solution to all the difficulties which can present themselves. They are the principles which govern all other accounts, and I can see no reason why they should not be held applicable to the accounts before us.

Thus, the court held that the rule in Clayton's Case applied despite the fact that, as noted by Lord Justice Knight Bruce at p. 383, the banks were indifferent to the contest because the beneficiaries of the customer claimed against the customer as a trustee, and not in a subrogated fashion against the banks as debtors to the customer.

In applying the rule in Clayton's Case, Lord Justice Turner stated at pp. 393-4:

Now Green opened and kept these banking accounts upon the usual footing, and the Plaintiff, taking the benefit of the accounts, cannot, as I think, be entitled to alter their character. Adopting them for the purpose of establishing his demand against Green's estate, he must, I think, adopt them with all their incidents, one of which is that the monies drawn out are to be applied to the monies first paid in.

It is not at all clear why a court could not apply the rule in Clayton's Case to determine which debts owed by the bank to its customer were paid off, and still apply tracing rules to allocate losses to the account among the customer as trustee and his innocent beneficiaries.

Of concern to Turner L.J. was the fact that a debt which had been extinguished at law would be revived in equity, thus causing "the greatest inconvenience". Yet that result derives from allowing tracing itself, the very principle for which the decision stands, regardless of the rule in Clayton's Case.

Unfortunately, on the facts of Pennell, the application of the rule in Clayton's Case permitted a trustee who disbursed money for his own purposes from a mixed account to claim that the moneys disbursed came from the first deposits of trust moneys, not the later deposits of his own moneys. As pointed out by Baggallay L.J. in Re Hallett's Estate, in Pennell, this peculiar result was unimportant. The moneys disbursed from the London account had to come out of the trustee's funds whether or not the rule in Clayton's Case applied, and with respect to the Bank of England account, the issue was not whether the appellants were entitled to (STERLING)4,077 or (STERLING)4,011, but whether they were entitled to anything at all. Unfortunately, Pennell set up a "straw man" upon which later cases were to focus. Later courts questioned whether the rule in Clayton's Case ought to apply as between the trustee and his beneficiaries, rather than whether, in principle, it ought to apply at all.

Such was the case in Re Hallett's Estate, supra, where a solicitor who was holding in trust three sets of bonds on behalf of two clients improperly sold them and deposited the proceeds into his bank account. The account already held (STERLING)1,976 of his own money. On November 14th, he deposited, first, (STERLING)770 belonging to the trustees of his marriage settlement and, second, (STERLING)1,804 belonging to Mrs. Cotterill. Though the trustee later made disbursements totalling (STERLING)2,662 and personal deposits of (STERLING) 1,320, at no time did the fund sink below the total of the two trust funds. An application of the rule in Clayton's Case, as defined by Pennell, would have resulted in the (STERLING) 2,662 being allocated first against the trustee's (STERLING) 1,796 then against Mrs. Cotterill's (STERLING)770, and finally against the marriage settlement's (STERLING)1,804. The result would have been that of the (STERLING)3,029 remaining in the fund, the marriage settlement would have received (STERLING)1,708, the trustee (STERLING)1,321, and Mrs. Cotterill nothing. The court looked to first principles in order to avoid the logic of Pennell. Jessel M.R. at p. 728 discussed the rule in Clayton's Case within the context of the modern theory of banking and the debtor-creditor relationship, but did not question its applicability as between a trustee and his beneficiaries. Instead, His Lordship focused on the presumed intention of the trustee to act honestly and disburse his own money for private purposes. Hence, the worst effect of the rule was avoided. His Lordship stated at p. 727:

> Now, first upon principle, nothing can be better settled, either in our own law, or, I suppose, the law of all civilised countries, than this, that where a man does an act which may be rightfully performed, he cannot say that that act was intentionally and in fact done wrongly.
>
> . . . . .
>
> When we come to apply that principle to the case of a trustee who has blended trust moneys with his own, it seems to me perfectly plain that he cannot be heard to say that he took away the trust money when he had a right to take away his own money.

Baggallay L.J. also did not question the applicability of the rule in Clayton's Case, stating at p. 738 with respect to Pennell:

> In these clear and forcible terms the Lords Justices enunciated the proposition that, as a general principle, the

rule in Clayton's Case must be applied to the banking accounts of trustees for the purpose of determining the proportions in which the cestuis que trust and general creditors, or the several classes of their cestuis que trust, are entitled to the debt due from the bankers in closing the account. To the general principle so enunciated I readily accede.

His Lordship also focused on the "presumed intention of the trustee", stating at pp. 742-3:

> But, dealing with the decision of the Lords Justices in Pennell v. Deffell, as I find it reported, I cannot regard it as satisfactory, if it is to be considered as establishing as a general proposition that in all such cases as that then under their consideration the presumption of an honest intention on the part of the trustee is to be altogether disregarded, however favourable to such a presumption the circumstances of any particular case may be, and that the rule of appropriating in strict order of date the drawings out to the payments in is alone to be applied. On the contrary, I entertain a very decided opinion that in cases like Pennell v. Deffell, or in such as that which is the subject of the present appeal, full effect should be given to the principle of attributing the honest intention whenever the circumstances of the case admit of such a presumption.

Baggallay L.J. also stated obiter at p. 743 that the rule in Clayton's Case applied to allocate losses as between beneficiaries:

> It may, of course, happen that, through the acts of a trustee, whether wilfully dishonest or not, the ultimate balance may not be sufficient to meet the full amounts of all the trust moneys which may have been paid into a blended banking account, and the question then raised may be as to the various claims in respect of distinct trusts; in such a case the strict application of the general rule of appropriating in order of date the drawings out to the payments in may, and probably would, be correct.

It is not at all clear why a trustee who acts dishonestly in mixing trust funds and withdrawing moneys for private purposes, if he is presumed to withdraw his own moneys first, cannot also be presumed to have intended to act "equitably" by stealing from each beneficiary in proportionate amounts. In any event, in Re Hallett's Estate, the balance was sufficient to pay off both beneficiaries in full.

The Ontario Court of Appeal dealt with the rule in Clayton's Case in the old case of Bailey v. Jellett et al. (1884), 9 O.A.R. 187. The facts are not as clear as they might be, but the essential transactions would seem to be as follows. On August 15th, a solicitor deposited $6,455.40 of Bailey's trust moneys and $45 of his own moneys into his own bank account. The solicitor then disbursed $1,599 from the bank account. Hence, at that point it would appear that Bailey could only trace $4,901.40 into the account. On August 24th, the solicitor deposited $1,182.95 of Mrs. Suzor's trust moneys into the account. He later disbursed $3,000 into Bailey's account. There were further deposits and disbursements, resulting in a balance of $2,991.45. Mrs. Suzor, of course, claimed $1,182.95 and it would seem that Bailey was able to trace and claim, at most, $4,901.40 less $3,000, or $1,901.40. Hence the shortfall in the account was some $93 (in fact $92.90).

The court held that Mrs. Suzor was entitled to priority. Spragge C.J.O. stated at p. 201:

> The only possible question could be as to the cheques amounting to $93, and as to them it may be necessary to resort to the rule in Clayton's Case as a convenient rule, where some rule is necessary.

However, the Chief Justice also found at pp. 201-2 circumstantial evidence of an intention on the part of the trustee not to touch Mrs. Suzor's money:

> There is indeed room for the presumption that Jellett drew those cheques intending not to touch Mrs. Suzor's money, for he had drawn against the plaintiff 's money before her money was paid in; and when he did make a payment to the plaintiff

he left unpaid a considerable sum which he might have paid, still leaving Mrs. Suzor's money intact.

Osler J.A. at pp. 209-10 followed Re Hallett's Estate and applied the rule in Clayton's Case:

I can see no distinction between the case of a solicitor and any other agent in this respect. That being so, the case of Re Hallett--Knatchbull v. Hallett, 13 Ch. D. 696, appears to be a sufficient authority for the contention that the plaintiff and Mrs. Suzor are respectively entitled to a charge on the balance at Jellett's credit in the bank and also, as Mr. Scott argued, that as between them the rule in Clayton's Case applies in dealing with the question of the appropriation of payments, so that the earliest drawings are to be appropriated to the earliest deposits.

Burton J.A. at p. 206 merely stated that Mrs. Suzor was entitled to follow the money and to have a first charge to the extent of her claim. The sum in dispute was quite small and it does not appear that the court examined the authorities or principles in any great depth.

The rule in Clayton's Case was refined by Sargant J. in James Roscoe (Bolton), Ltd. v. Winder, [1915] 1 Ch. 62, where he stated at p. 69:

Certainly, after having heard In re Hallett's Estate stated over and over again, I should have thought that the general view of that decision was that it only applied to such an amount of the balance ultimately standing to the credit of the trustee as did not exceed the lowest balance of the account during the intervening period.

In that case, the initial deposit of trust funds was in the amount of (STERLING)455, but the balance in the account had declined to (STERLING)25 prior to further deposits of the trustee's own moneys being made. Though the final balance in the account was (STERLING)358, Sargant J. held that the beneficiary could only trace (STERLING)25 into the final balance. Hence, Sargant J. in a sense resorted to the general rules of tracing when allocating losses and distributing the balance of the fund according to the rule in Clayton's Case.

In Re Diplock; Diplock v. Wintle, [1948] Ch. 465, the facts of which have been referred to supra, one of the issues which arose was whether or not the rule in Clayton's Case applied to disbursements from an active banking account. The court stated at pp. 553-4:

> It might be suggested that the corollary of treating two claimants on a mixed fund as interested rateably should be that withdrawals out of the fund ought to be attributed rateably to the interests of both claimants. But in the case of an active banking account this would lead to the greatest difficulty and complication in practice and might in many cases raise questions incapable of solution. What then is to be done? In our opinion, the same rule as that applied in Clayton's case should be applied. This is really a rule of convenience based upon so-called presumed intention. It has been applied in the case of two beneficiaries whose trust money has been paid into a mixed banking account from which drawings were subsequently made, and, so far as we know, its application has not been adversely criticized (see per Fry J. in Hallett's case and per North J. in In re Stenning). In such a case both claimants are innocent, neither is in a fiduciary relation to the other, and if the mixed fund had not been drawn upon they would be entitled to rateable charges upon it. Exactly the same occurs where the claimants are not two beneficiaries but one beneficiary and one volunteer, and we think, accordingly, that the same principle should be adopted.

The difficulties envisaged by the court were not elaborated upon. Indeed, the court did not apply tracing rules to a claim against a mixture of stock which had been subject to similar dealings and depletions.

In Corbett et al. v. McKee, Calabrese & Whitehead et al. (1984), 16 E.T.R. 200 (N.B.Q.B.), Stevenson J. followed Pennell J. in Re Law Society of Upper Canada and Riviera Motel (Kitchener) Ltd. et al. (1981), 33 O.R. (2d) 65, 123 D.L.R.

(3d) 409, 9 E.T.R. 188 sub nom. Re Delaney, the facts of which are cited supra. In Re Law Society, Pennell J. applied the rule in Clayton's Case to distribute the funds remaining in a bank account between two innocent beneficiaries, with the result that the beneficiary whose funds were deposited second in time received $54,633.08, and the first beneficiary received nothing (on a claim which, by the rules of tracing could only have amounted to $4,447.33). In Corbett, a solicitor deposited $11,853.43 belonging to Corbett into his trust account. He then disbursed $349.50 for firm fees and $1,420 for realtor's fees, so that in fact only $10,093.93 of Corbett's money remained in the account. The solicitor then deposited $8,419.16 of moneys belonging to other clients into the account. The claims were thus for $8,419.16 and $10,093.93, whereas the balance in the fund was $15,687.54. Stevenson J. held that the other clients had priority and that the loss had to be allocated against Corbett's interest.

Other cases which have applied or commented upon the rule in Clayton's Case are: Hancock v. Smith (1889), 41 Ch. D. 456; Re Stenning; Wood v. Stenning, [1895] 2 Ch. 433; Mutton v. Peat, [1899] 2 Ch. 556; British Canadian Securities Ltd. v. Martin et al., [1917] 1 W.W.R. 1313, 27 Man. R. 423; Re Coville Transport Co. Ltd. (1947), 28 C.B.R. 262, and Re C. A. Macdonald & Co. Ltd. (1958), 17 D.L.R. (3d) 416, 26 W.W.R. 116, 37 C.B.R. 119.

Having reviewed the authorities on the origins and extension of the rule in Clayton's Case, and the views of the academic commentators, it is my view that the rule in Clayton's Case arose out of the debtor-creditor relationship and should be restricted to that relationship. In my view, the general equitable rules of tracing, as stated in Re Diplock, supra, at pp. 533 and 539, are quite capable of dealing with the problem of allocating losses to a mingled fund.

In the present case, the trustee and the beneficiaries originally had an interest in the mingled fund in proportion to their respective traceable contributions to the fund. As between the trustee and the beneficiaries, the beneficiaries ranked ahead of the trustee with respect to their claims to the mingled fund. Hence, losses to that fund must first be allocated against the interest of the trustee in the fund.

As between the two innocent beneficiaries, they each had an interest in the mingled fund in proportion to their respective traceable contributions to the fund. Those interests ranked equally. Therefore, losses to that fund should be allocated against the interests of the beneficiaries in proportion to their respective traceable interests in the fund at the time the loss occurred. Hence, the beneficiaries (and the trustee to the extent of his remaining interest after losses have been deducted) would rank equally and share proportionately in the remaining funds. I express no opinion on the power of the court to make a disposition on some other basis where it is not possible to determine what proportion the mixed funds bear each to the other.

In Gibbs v. Gerberich (1964), 203 N.E. 2d 851, the Court of Appeals of Ohio reached a similar result. In that case, the realtors deposited and commingled moneys, received by them from the sale of clients' properties, in a bank escrow account. The deposits were made at various times, and in between deposits the realtors made withdrawals from the account for private purposes. Doyle J. referred to the rule in Clayton's Case, but instead applied the formula adopted by the Restatement, Restitution, s. 213, comment (c), which I have referred to supra. The losses were allocated against each person in proportion to his traceable interest in the fund at the time the loss was sustained.

The application of the general equitable rules of tracing referred to supra is both logical and fair. In this age of computerized banking, it can hardly be argued that in most instances an application of such principles will cause much inconvenience, difficulty or complication. These same principles are often applied to quite complicated dealings which do not involve bank accounts.

I am not unaware of the dangers inherent in a trial judge acting on his own views in the face of established authority. However, on the question of the applicability of the rule in

Clayton's Case, it cannot be argued that trustees who wrongfully mingle and dissipate the funds of their beneficiaries do so with the aim of stealing from one innocent beneficiary rather than the other on the basis of date of deposit. At most, it may be argued that beneficiaries have, in the past, on the basis of the rule, failed to make a proprietary claim or compromised suits. Nevertheless, it is a hard argument that one ought to continue to apply an unfair rule because some in the past have suffered by it.

I note with some satisfaction the words of Baggallay L.J. in Re Hallett's Estate, a case which itself reversed a decision which had been followed for some 30 years, where His Lordship stated at pp. 744-5:

> The question, then, remains whether Pennell v. Deffell is an authority so binding upon this Court that, however decided may be the collective or individual opinions of its members as to what, in the absence of authority, should be done in the matter of this appeal, we are bound to disregard them, and to shape our decision in accordance with what was decided in that case. My answer to that question must be in the negative. I fully recognise and appreciate the evils which in many cases would arise if the Judges of the Court of Appeal, or, indeed, if any other Court or Judge, were to act upon their individual views, regardless of what is generally understood by the expression "authority". Repeated decisions have established rules for determining the construction of particular words when used in wills, and other wills have been prepared and executed upon the faith of such words receiving the like construction. Titles have been acquired and lands dealt with upon the footing of the law being as enunciated in the judgments pronounced in other cases. And so, again, in matters of commercial business, contracts have been entered into upon the faith of certain rules, originating in the decisions of the Courts, being recognised as conclusive. Now, in such cases as these, and in others which will readily suggest themselves, the greatest injustice might be occasioned by a Court or a Judge treating such decisions as having been erroneously arrived at, and thereby creating doubt and uncertainty as to a rule of law which had

previously been treated as well and clearly defined. But no such injustice could arise in consequence of our dissenting from the decision in Pennell v. Deffell, and giving effect to such dissent. It can hardly be suggested that since that decision any trustee has kept and dealt with a blended banking account upon the faith that, as between his general creditors and his cestuis que trust, the rule adopted in that case would also be adopted after his death in dealing with his ultimate balance. If a trustee had acted upon any such view, he could hardly be considered as having had an honest intention.

I further note the words of Jessel M.R. at p. 710 in the same case concerning the flexibility of the rules of equity:

I intentionally say modern rules, because it must not be forgotten that the rules of Courts of Equity are not, like the rules of the Common Law, supposed to have been established from time immemorial. It is perfectly well known that they have been established from time to time--altered, improved, and refined from time to time. In many cases we know the names of the Chancellors who invented them. No doubt they were invented for the purpose of securing the better administration of justice, but still they were invented. Take such things as these: the separate use of a married woman, the restraint on alienation, the modern rule against perpetuities, and the rules of equitable waste. We can name the Chancellors who first invented them, and state the date when they were first introduced into Equity jurisprudence; and, therefore, in cases of this kind, the older precedents in Equity are of very little value. The doctrines are progressive, refined, and improved; and if we want to know what the rules of Equity are, we must look, of course, rather to the more modern than the more ancient cases.

Application of rules of tracing to the Greymac Trust General Account and Crown Trust Savings Account

The total deposits in the Greymac Trust General Account by December 15, 1982, were $5,696,000, the respective traceable contributions being $4,683,000 on the part of the companies,

$841,285.26 on the part of the Participants, and $172,314.74 on the part of the trustee, Credit. The parties each had an interest in the account proportionate to their respective traceable contributions to the account.

On December 17, 1982, $4,000,000 was disbursed into the Crown Trust Savings Account. The three parties each had an interest in the Crown Trust Savings Account proportionate to their respective traceable interests in the Greymac Trust General Account at the date the $4,000,000 was disbursed from the latter account and put into the former account.

The $8,773,000 deposit and $8,774,000 disbursement can be ignored for the purposes of this calculation. If they occurred after the $4,000,000 disbursement, they are irrelevant to a determination of the proportionate relationship between the traceable interests in either account as of the time of that disbursement.

If they preceded the $4,000,000 disbursement, then they still do not affect the determination of the proportionate relationship between the traceable interests. If the $8,773,000 deposit belonged to the companies, the $8,774,000 disbursement to the companies would have come out of the companies' interest. If the $8,773,000 deposit belonged to the trustee, the $8,774,000 disbursement to the companies as creditors would have come out of the trustee's interest. In either case, the proportionate relationship of the traceable interests in the Greymac Trust General Account at the time of the $4,000,000 disbursement would have remained unchanged.

There is no evidence before me that the $4,000,000 disbursement occurred after the $8,773,000 deposit and before the $8,774,000 disbursement. If the transactions did occur in that order, it is my view, on the basis of the similarity in the amount of the deposit and the disbursement and the contemporaneity of the transactions that the intent of the trustee was that the $8,774,000 disbursement be allocated against the $8,773,000 deposit so as not to affect the proportionate relationship of the various interests, regardless of whether the transaction involved the companies' or the trustee's funds. Hence, the proportionate relationship would have remained unchanged.

The interests of the respective parties in the Crown Trust Savings Account were thus -- to the companies: $3,288,277.22; to the Participants: $590,727.99, and to the trustee, Credit: $120,994.79. However, the trustee's interest was subject to any outstanding claims, if any, to the Greymac Trust General Account.

At the end of the series of transactions on December 17, 1982, $1,696,600 remained in the Greymac Trust General Account. Each party had an interest in that amount proportionate to their respective traceable contributions to the account, that is, $1,394,722.78 to the companies, $250,557.28 to the Participants, and $51,319.94 to Credit.

After December 21, 1982, $393,000, $390,000, $557,000 and the $3,191.34 mentioned supra, or a total of $1,343,191.34 were disbursed and dissipated from the Greymac Trust General Account, leaving a total of $353,408.66 in the account.

With respect to the $976,000 deposit and $975,000 disbursement, as long as they occurred in that order and one after the other, they are irrelevant to a determination of both the proportionate relationship between the respective traceable interests, and the allocation of any losses based on that relationship, prior to the deposit and disbursement. They also cannot affect the determination of both the proportionate relationship between the respective traceable interests, and the allocation of any losses based on that relationship, after the deposit and disbursement, for the reasons referred to in respect of the December 17th transactions.

There is no evidence before me that the $390,000 disbursement occurred after the $976,000 deposit and before the $975,000 disbursement. If the transactions did occur in that order, it is my view, on the basis of the similarity in the amount of the deposit and the disbursement and the contemporaneity of the transactions, that the intent of the trustee was to allocate the $975,000 disbursement against the $976,000 deposit so as to not affect the proportionate relationship of the various interests, regardless of whether the transaction involved the companies' or the trustee's funds.

There is no evidence before me that the $975,000 disbursement preceded the $976,000 deposit, and given my views of the intent of the trustee, it is a reasonable inference that the transactions did not occur in that order.

Because the proportionate relationship of the respective traceable interests remained the same after December 21, 1982, for convenience sake, the allocation of the $1,343,191.34 in losses can be computed as one sum on the basis of that proportionate relationship.

The total loss of $1,343,191.34 must first be allocated against the trustee's interests. Since it exceeds the trustee's interests in both accounts, those interests are reduced to zero.

With respect to the Greymac Trust General Account, the companies and the Participants had respectively, prior to the loss, traceable interests in the account of $1,394,722.78 and $250,557.28, for a total of $1,645,280.06. Therefore, on a proportionate basis, the companies and the Participants are respectively entitled to $299,588.58 and $53,820.08 out of the $353,408.66 remaining in the Greymac Trust General Account.

The companies have thus recovered $299,588.58 from the Greymac Trust General Account, and $3,288,277.22, their interest in the Crown Trust Savings Account, for a total of $3,587,865.80 out of a $4,683,000 claim. The Participants have thus recovered $53,820.08 from the Greymac Trust General Account, and $590,727.99, their interest in the Crown Trust Savings Account, for a total of $644,548.07 out of a $841,285.26 claim. Therefore, the total loss to the two beneficiaries has been $1,291,871.39 of which the companies' share is $1,095,134.20 and the Participants' share is $197,737.19. Thus, the companies and the Participants are entitled, in proportion to their respective share of the total losses, to $102,568.67 and $18,427.12 out of the trustee's

$120,944.79 interest in the Crown Trust Savings Account.

To summarize, the companies and Participants are entitled to recover respectively $299,588.58 and $53,820.08 from the Greymac Trust General Account, and to recover respectively $3,390,845.89 and $609,154.11 from the Crown Trust Savings Account.

Interest accumulated in the two accounts since January, 1983, shall be distributed in accordance with the parties' respective proportionate interests in the particular account on that date.

No order as to costs.

Judgment accordingly.