Court File No. M44123
M44124

COURT OF APPEAL FOR ONTARIO

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF COMPROMISE OR ARRANGEMENT OF THE CASH STORE FINANCIAL SERVICES INC., THE CASH STORE INC., TCS CASH STORE INC., INSTALOANS INC., 7252331 CANADA INC., 5515433 MANITOBA INC., 1693926 ALBERTA LTD DOING BUSINESS AS "THE TITLE STORE"

Applicants

JOINT RESPONDING FACTUM OF THE DIP LENDERS AND THE AD HOC COMMITTEE

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PART I - OVERVIEW

1. This is an appeal of factual findings.

2. On the motion below, Regional Senior Justice Morawetz was asked to characterize relationships based on criteria and facts presented by parties in an ongoing CCAA proceeding. The moving parties sought an order declaring that they owned certain property held by the insolvent Applicants (**Cash Store**), which would have allowed them to extract that property from Cash Store's estate. The Respondents argued that the moving parties were mere creditors of Cash Store.

3. No particular legal tests were relied on by either side. The moving parties claimed that certain indicia, given the facts of the case, militated towards their position that they owned the subject property. The Respondents presented other facts and indicia in support of their position that these relationships were debtor/creditor relationships.

4. The facts relied on by the moving parties were largely descriptive. They pointed to the terms of written agreements, comments made in public disclosure, and the subjective expectations of individuals involved in these relationships. By contrast, the Respondents provided facts about how these relationships actually functioned in practical and economic terms, relying on financial data and the actual extent of the risk assumed and benefits received by the parties.

5. There were notable conflicts in the evidence. Justice Morawetz was asked to sift through all the facts and discrepancies and apply the various indicia set out by the parties. Ultimately, he was convinced that the relationship was, in substance and in practice, that of debtor and creditor, and dismissed the moving parties' motion. His conclusions are practical, reasoned and, most importantly, inherently factual.

6. The Appellants now seek to re-argue the facts amply set out before Justice Morawetz. In doing so, they mischaracterize the motion below with legal arguments of limited significance to the substance of Justice Morawetz's decision. It is neither necessary nor appropriate to revisit the factual determinations of the court below. This appeal is without merit and should be dismissed.

PART II - FACTS

The Parties and Their Relationship

7. Cash Store is in the business of payday lending.[1] On April 14, 2014, Cash Store obtained an initial order (the **Initial Order**, subsequently amended and restated) pursuant to the CCAA allowing for, *inter alia*, a stay of proceedings while it pursues restructuring efforts.[2]

8. As part of Cash Store's business, third party lenders (the **TPLs**) lent funds to Cash Store that Cash Store subsequently lent to retail customers. Trimor Annuity Focus LP #5 (**Trimor**) and 0678786 BC Ltd. (**McCann**), the moving parties, were among those TPLs.[3]

9. On paper, Cash Store obtained funds from the TPLs (the **TPL Funds**), which Cash Store, as broker, would lend to its brokered loan customers. On paper, those loans appeared to be assigned to the TPLs. On paper, the TPLs appeared to own all payments received from the brokered loan customers.[4]

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[1] Endorsement of Morawetz, RSJ. dated August 5, 2014, 2014 ONSC 4326 (**Morawetz Endorsement**), Joint Appeal Book and Compendium of the Respondents (**Responding Compendium**), Tab 1, at para. 1.
[2] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 12.
[3] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 9 and 10.
[4] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 3.

10. Contrary to the assertions of the TPLs, Cash Store has not conceded that the written agreements (the **Broker Agreements**) between the parties created a relationship whereby Cash Store acted, in practice, as a broker of payday loans for the TPLs. While the written agreements created the framework for such an arrangement, the mechanisms in the written agreements were not used and, in practice, no such broker relationship existed.

11. In practice, Cash Store borrowed money from the TPLs. In practice, the TPLs were ordinary creditors of Cash Store[5] and (until April of this year in connection with the commencement of the CCAA proceeding) receipts from the brokered loan business were regularly commingled in Cash Store's general account, consistent with past practice.[6]

12. McCann's principal acknowledged McCann's status as a creditor in various email correspondence with Cash Store:

> You mentioned you were meeting with Steve and Craig this morning to discuss our loan to back stop Ontario payday loan customers and the requirements for funds in regulated provinces. [...] As you know we went to considerable effort and legal cost to get the opinion and comfort that we required to assure **that funds loaned to Cash Store** were an ok investment because they were secured by loans and the promise of Cash Store for proper accounting of those loans.[7]
>
> I have attempted to contact you on numerous occasions and have left messages on your cell, office phone and with Sandy. Attempting to keep a **creditor** and friend in the dark by ceasing all communication is neither the way to treat a friend nor a **creditor**.[8] [emphasis added]

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[5] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 126 – 127.
[6] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 5, 24, 27 – 30 and 127.
[7] E-mail from J. Murray McCann to Gordon Reykdal dated March 14, 2014, Responding Compendium, Tab 10.
[8] E-mail from J. Murray McCann to Gordon Reykdal dated April 12, 2014, Responding Compendium, Tab 11.

13. In practice, Cash Store made two kinds of monthly value transfers to the TPLs in respect of the borrowed money:

(a) **Cash Payments**: Cash Store made monthly cash payments to the TPLs, which purportedly combined interest earned from customer loans with "retention payments". In practice, the TPLs were effectively guaranteed an annual rate of return on their advances of 17.5%, irrespective of the financial performance of the loans made to Cash Store's customers. Cash Store fulfilled this guarantee by making cash payments each month to the TPLs, which amounted to a return of 17.5% per annum based on the TPLs' original loans to Cash Store; and

(b) **Accounting Transfers**: in addition to the monthly cash 17.5% interest payments, Cash Store also used a "capital protection" scheme to maintain the level of principal advanced by the TPLs and offset the high default rate of the underlying payday loans. Cash Store made regular book or accounting transfers to "assign" additional customer loans to the TPLs and repurchased underperforming loans from the TPLs, thereby offsetting any erosion of the loan portfolios that the TPLs purported to hold through the brokered loan arrangements with Cash Store. The monthly cash payments of 17.5% interest were always calculated based on the total amount of principal advanced by each TPL to Cash Store, and not on the value of any underlying customer loans.[9]

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[9] Affidavit of Steven Carlstrom sworn April 14, 2014, Responding Compendium, Tab 9, at para 84; See also McCann Lender Disbursement Summary, March 2014 (CH0001836), Responding Compendium, Tab 14.

14. Taken together, these practices had the effect of ensuring that the TPLs had no exposure to the risk that Cash Store's payday loans would not be repaid. The only risk the TPLs faced was with respect to Cash Store's own operations, consistent with a debtor/creditor relationship between Cash Store and the TPLs.

15. In support of their position, representatives of both McCann and Trimor stated that they believed the TPL Funds to have been held by Cash Store in trust for the TPLs,[10] and Trimor stated that Cash Store had assured Trimor that it would treat Trimor's funds as having been held in trust.[11] However, on cross-examination, Trimor conceded that:

> (a) this assurance was made regarding an earlier form of Broker Agreement that did contain trust language; and
>
> (b) the current Broker Agreement contained no trust language whatsoever.[12]

16. Sharon Fawcett, a McCann representative, testified that, at the time the Broker Agreement was entered into in June 2012, Cash Store represented that funds advanced by McCann would be placed in a "Designated Broker Bank Account, which would be separate and apart from Cash Store Financial's general operating account."[13] However, in July 2012, in response to an e-mail from Ms. Fawcett to Cash Store seeking confirmation that TPL Funds were segregated, a Cash Store representative expressly confirmed that they were not:

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[10] Affidavit of Sharon Fawcett sworn April 11, 2014, Responding Compendium, Tab 5, at paras. 15 and 21; Affidavit of Erin Veronica Armstrong sworn April 13, 2014, Responding Compendium, Tab 6, at para. 15.
[11] Supplementary Affidavit of Erin Veronica Armstrong sworn May 8, 2014, Responding Compendium, Tab 7, at para 6.
[12] Cross-Examination of Erin Veronica Armstrong dated May 21, 2014, Responding Compendium, Tab 4, at qq. 65-66.
[13] Affidavit of Sharon Fawcett sworn April 22, 2014, Responding Compendium, Tab 8, at para 3.

> In the new agreement, we've tried to combine all these accounts and not to have a designated broker bank account. Your funds specifically would be tracked separately via our accounting system.[14]

17. Furthermore, Cash Store explicitly deposed that the TPLs had not availed themselves of available protections in the Broker Agreements that would have prevented commingling of TPL Funds with operating cash, and so TPL Funds had been commingled:

> While the Broker Agreements permit the TPLs to require Cash Store to hold the TPL Funds in accounts designated for that purpose, no TPL has designated any account as a Designated Financier Bank Account or a Designated Broker Bank Account. The Restricted Cash is comingled with all of Cash Store's other cash [...].[15]

Commencement of CCAA Proceedings

18. At the commencement of the CCAA proceeding, a dispute arose over the entitlements of the TPLs and Cash Store to certain funds in the hands of Cash Store. At the core of this dispute is the question of whether (as Justice Morawetz found) the TPLs loaned their funds to Cash Store, which in turn made loans to its customers, or whether (as the TPLs asserted) the funds were owned by the TPLs and loaned by the TPLs to Cash Store's customers, with Cash Store merely operating as a broker.

19. In April of this year, temporary measures were put in place by the CCAA court to segregate receipts from the brokered loan business pending determination of the dispute. These protective measures were short-term steps to ensure that the parties' positions were preserved pending resolution of the matters that were the subject of the motion below. These measures were without prejudice to the rights of the parties to

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[14] E-mail from Michael Zvonkovic dated July 23, 2012, Responding Compendium, Tab 12.
[15] Carlstrom Affidavit, Responding Compendium, Tab 9, at para 79.

assert any of the arguments made at the court below and remained subject to further order of the court.[16]

20. The TPLs brought motions to extract their alleged funds, claiming that the funds held by Cash Store were the property of the TPLs, or alternatively were trust property held by Cash Store for the TPLs.[17]

Justice Morawetz's Decision

21. On August 5, 2014, Justice Morawetz issued an order dismissing the TPLs' motions.

22. Justice Morawetz reviewed extensive volumes of affidavit evidence and cross-examination transcripts and heard multiple days of oral submissions prior to issuing that decision. Further, the TPL issues had been the subject of several appearances before Justice Morawetz prior to the hearing that led to that decision.

23. Factual findings were made by Justice Morawetz in a 24-page decision about the operating relationship between Cash Store and the TPLs. Some key findings were:

(a) in practice, the funds advanced by the TPLs were not segregated from each other, or from operating cash. Rather, "there was one account and it is not possible to identify the source of the funds"[18];

(b) Cash Store would make monthly "retention" payments to the TPLs to provide a 17.5% rate of return (the equivalent of interest) on funds advanced by the TPLs. The TPLs received these monthly payments from Cash Store

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[16] Amended and Restated Initial Order of Morawetz RSJ., Responding Compendium, Tab 2, at paras. 30 – 35; Order (Additional TPL Protections) of Morawetz RSJ., Responding Compendium, Tab 3, at para. 6.
[17] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 9, 10, 36 and 63.
[18] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 122.

regardless of the payment status of the loans made by Cash Store to its customers[19]; and

(c) the TPLs were insulated from any credit risk from Cash Store's customers as a result of the capital protections used by Cash Store.[20] These capital protections effectively indemnified the TPLs for any losses arising from underperforming payday loans.

24. In other words, the evidence showed that monies were advanced by the TPLs, commingled in the Cash Store general account, the TPLs received interest payments from Cash Store at a rate of 17.5% and the TPLs were not directly exposed to the credit risk of any of Cash Store's customers, only to Cash Store's credit risk. The TPLs were creditors of Cash Store, and not creditors of Cash Store's customers.

25. Justice Morawetz determined from these facts that the cash advanced by the TPLs to Cash Store for purposes of making loans was not the property of the TPLs and was not held in trust for the TPLs. Instead, it was loaned to Cash Store and gave rise to a relationship of debtor and creditor as between Cash Store and the TPLs.[21]

PART III - ISSUES AND LAW

26. The issues to be determined on this appeal are as follows:

(a) Did Justice Morawetz err in characterizing these relationships as being between debtor and creditor?

(b) Did Justice Morawetz err in finding that the parties had agreed by conduct to vary the terms of their agreement?

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[19] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 4, 123 and 124.
[20] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 124.
[21] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 126 and 130.

(c) Did Justice Morawetz err in weighing the evidence?

(d) Did Justice Morawetz err with respect to Part XII of the *Bankruptcy and Insolvency Act*?

A. The Motion Below – Characterizing the Relationship

27. The TPLs' motion before Justice Morawetz sought declarations that certain funds in the hands of Cash Store, or to be received in the future by Cash Store, were owned by the TPLs or held in trust for the benefit of the TPLs.

28. The TPLs asked the CCAA court to resort to equitable principles to conclude that certain property was owned by or held in trust for the benefit of the TPLs. This required an evaluation of all of the circumstances surrounding the relationships of the parties. It was an exercise in characterization based on the specific facts of the case.

29. There is no bright line legal "test" available to the court when determining whether a party's claim in an insolvency is some form of claim to ownership of property or a claim *qua* creditor. In asserting its property claim, Trimor correctly took the position that:

> ...in determining the issue of ownership, it is important to carefully consider the facts...[22]
>
> ...the DIP Lenders correctly note that Cash Store's legal relationship with the TPLs is not exhaustively defined by the Broker Agreements. The conduct of the parties is also relevant.[23]

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[22] Reply and Responding Factum of Trimor Annuity Focus Limited Partnership #5 (**Reply Factum of Trimor**), dated June 5, 2014, Responding Compendium, Tab 15, at para. 5.
[23] Reply Factum of Trimor, Responding Compendium, Tab 15, at para. 15.

30. While the TPLs are notably silent with respect to consignment, trust or other property principles on this appeal, those were precisely the principles that the TPLs asked Justice Morawetz to consider and apply:

> By applying these indicia of ownership to the broker-lender relationship between McCann and Cash Store, it becomes clear that McCann retained ownership of the McCann Property at all times. [...]
>
> Courts should consider all of the indicia of ownership set out in *BC Tel*. [...]
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> As with the indicia of ownership from *BC Tel*, the true consignment indicia identified in *Access Cash* strongly militate for interpreting the Broker Agreement as creating a relationship pursuant to which McCann retained ownership of the McCann Property at all material times. [...][24]

i. Determining appropriate indicia

31. On the motion below, the TPLs put forth a number of indicia that they claimed indicated ownership of property, including the intention of the parties, ownership risk and whether the property is segregated from other property.[25]

32. Similarly, there is no complete list of the factors that establish a debtor/creditor relationship. The most prominent factors in this analysis are:

(a) whether the property that is the subject of the claim was segregated or commingled;

(b) whether the claimant was entitled to interest in connection with the property advanced; and

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[24] McCann Motion Factum, Responding Compendium, Tab 16, at paras. 56, 61 and 65.
[25] See, for example, McCann Motion Factum, Responding Compendium, Tab 16, at paras. 55 and 64.

(c) whether the claimant is subject to the risk of loss of the property in possession of the party against which the claim is made.

33. The significance of segregation of the disputed property to the ownership determination was recognized over a century ago in *Henry v. Hammond*[26], a leading case on this matter that continues to be applied in Canada[27]:

> It is clear that if the terms upon which the person receives the money are that he is bound to keep it separate, either in a bank or elsewhere, and to hand that money so kept as a separate fund to the person entitled to it, then he is a trustee of that money and must hand it over to the person who is his cestui que trust. If on the other hand he is not bound to keep the money separate, but is entitled to mix it with his own money and deal with it as he pleases, and when called upon to hand over an equivalent sum of money, then, in my opinion, he is not a trustee of the money, but merely a debtor.[28]

34. The payment of interest is also a critical factor in this analysis. According to Waters: "If interest is to be paid, the relationship is nearly always that of creditor and debtor."[29] The British Columbia Supreme Court has accepted this view, stating that the payment of interest, while not determinative, is an objective fact that normally indicates a debtor/creditor relationship was intended.[30]

35. Whether the property claimant bears the risk of loss of the property that is in possession of the purported trustee is a logical factor to consider. This factor requires a consideration of whether the trust claimant has the risk of an owner with respect to the particular property in question. As stated by a leading authority: "[T]he debtor always remains liable to the creditor until the debt is paid. The trustee, however, is not

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[26] [1913] 2 K.B. 515.
[27] See, for example, *General Publishing Co. (Re)* (2002), 34 C.B.R. (4th) 186 at para. 3 (Ont. C.A.); *Water Street Pictures Ltd. v. Forefront Releasing Inc.,* 2006 B.C.C.A. 459 at para. 18.
[28] *Henry v. Hammond, supra* at 521.
[29] Donovan Waters, Mark Gillen & Lionel Smith, *Waters' Law of Trusts In Canada*, 4th ed. (Toronto: Thomson Reuters Canada Limited, 2012) at 92 [emphasis added].
[30] *Giles v. Westminster Savings Credit Union,* 2006 B.C.S.C 141 at para. 213.

personally obligated to compensate the beneficiaries if the trust property is lost other than through the trustee's own fault."[31]

36. Justice Morawetz reviewed the question of whether a debtor/creditor relationship existed or whether the TPLs owned the TPL Funds. Based upon the circumstances of the current case, it was found that the above indicia of a debtor/creditor or ownership relationship should be applied. In substance, the TPLs' appeal in this case raises questions about the manner in which Justice Morawetz applied the various indicia set out by the parties – whether to ownership, trust, or a debtor/creditor relationship – to the facts of this case and the conclusions drawn from that application.

ii. Characterizing the relationship

37. After the parties had set out the various indicia that each claimed supported their position, they attempted to support their characterization of the relationship with the specific facts of the case.

38. The following facts, among others, were considered by the Court below in performing that characterization exercise:

(a) the terms of the Broker Agreements contemplated that the TPLs would "own" all payments received from customers of the brokered loan business and that the funds claimed by the TPLs may be segregated;[32]

(b) the manner in which the Cash Store business operations were conducted differed substantially from the arrangement described in the Broker Agreements:[33]

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[31] A.H. Oosterhoff et al, *Oosterhoff on Trusts: Text, Commentary and Materials*, 6th ed. (Toronto: Thomson Canada Limited, 2004) at 104.
[32] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 3.

(i) the TPLs provided Cash Store with initial tranches of funds;

(ii) the funds were lent to Cash Store customers in the name of the TPL (in Trimor's case but not McCann's);[34]

(iii) Cash Store customers, if not in default, repaid the borrowed funds to Cash Store, together with interest of 59%;[35]

(iv) Cash Store deposited the returned funds and interest to a general account, there was no flow through to the TPLs;[36]

(v) Payments received from Cash Store customers were used in Cash Store's operations and were not kept in a segregated account for the TPLs, and the TPLs did not audit the accounts of Cash Store;[37]

(vi) Cash Store made payments to the TPLs in order to ensure that the TPLs received a fixed 17.5% return;[38]

(vii) Cash Store provided voluntary "capital protections" to the TPLs, insulating them from customer credit risk, meaning that the TPLs did not bear any risks of non-payment of a particular customer loan that an owner of that loan would have;[39]

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[33] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 4 and 83.
[34] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 83-84, 120-121.
[35] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 83 and 123.
[36] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 83 and 122-123.
[37] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 5.
[38] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 49, 64 and 90.
[39] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 92.

(viii) Cash Store made new loans to customers, from the general account;[40] and

(ix) Cash Store recorded a receivable for the TPL, with respect to the re-lent funds;[41]

(c) McCann stated that at all times it understood un-deployed monies to be held separate and apart from Cash Store's other accounts. However, McCann also described its disputed funds as having been "loaned to Cash Store" and the payments received from Cash Store as "interest". McCann also described itself as a "creditor" of Cash Store;[42] and

(d) Trimor contended that it only made funds available as a result of representations that the funds were segregated, held in trust, and used only for a specific purpose. However, Cash Store's evidence made clear that TPL funds were commingled with Cash Store's other funds, and that the TPLs were told that their specific funds were not being segregated. Further, the Broker Agreements contained no trust language supporting Trimor's assertion of a trust relationship.[43]

39. Justice Morawetz weighed the facts presented and made the following determinations based upon the facts considered:

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[40] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 83.
[41] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 83.
[42] E-mail from J. Murray McCann to Gordon Reykdal dated March 14, 2014, Responding Compendium, Tab 10; E-mail from J. Murray McCann to Gordon Reykdal dated April 12, 2014, Responding Compendium, Tab 11; E-mail from Sharon Fawcett to J. Murray McCann dated March 4, 2014, Responding Compendium, Tab 13.
[43] Supplementary Armstrong Affidavit, Responding Compendium, Tab 7, at para 6; Armstrong Cross-Examination, Responding Compendium, Tab 4, at qq. 65-66.

(a) the relationship as originally set out in the Broker Agreements was examined and traced through conduct subsequent to the execution of the Broker Agreements;[44]

(b) the fact that the TPLs expected to receive, and did receive, periodic payments at a rate equivalent to 17.5% reflected the fact that the TPLs were receiving interest payments (or their equivalent) from Cash Store throughout the relevant period. This was found to be clearly inconsistent with the ownership claim raised by the TPLs and consistent with a finding of a debtor/creditor relationship;[45]

(c) the 59% interest that would have flowed through to the TPLs in a true trust arrangement was never expected to flow through in the current circumstances;[46] and

(d) finally, the TPLs were not exposed to the credit risk of the underlying loans that they claimed were held in trust for them due to capital protections provided by Cash Store. In other words, the TPLs did not bear any of the risks associated with ownership of these loans.[47]

40. On the facts, Justice Morawetz found that the TPLs were creditors of Cash Store, and not creditors of Cash Store's customers.

iii. This is an appeal of factual determinations

41. The motion decision was rendered based on factual determinations. No relevant legal principle that is readily extricable from the factual circumstances of the commercial

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[44] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 118.
[45] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 126
[46] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 125.
[47] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 124.

dealings between the TPLs and Cash Store is at issue on this appeal.[48] In contrast to questions of law, which are questions about what the correct legal test is,[49] no "legal test" is under consideration in this case.

42. Instead, in order for Justice Morawetz to arrive at a decision, he was required to make various factual findings regarding the nature of the relationship between Cash Store and the TPLs, and to determine the extent to which the specific terms of the Broker Agreements were borne out by the relationship between the parties in practice. In so doing, Justice Morawetz' method corresponded with the holistic approach argued for by the TPLs on the motion below.[50]

43. In *Shelanu Inc. v. Print Three Franchising Corporation*,[51] this Court considered the scenario where subsequent oral agreements conflicted with the text of an original, written agreement. This Court stated that where there is such a conflict, the intention of the parties as inferred from the evidence as a whole is paramount:

> Where the parties have, by their subsequent course of conduct, amended the written agreement so that it no longer represents the intention of the parties, the court will refuse to enforce the written agreement. This is so even in the face of a clause requiring changes to the agreement to be in writing. See Colauitti Construction Ltd. v. City of Ottawa (1984), 46 O.R. (2d) 236, 9 D.L.R. (4th) 265 (C.A.) per Cory J.A.
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> On appeal, the appellant has conceded the existence of the oral agreement and its terms but asks this court to enforce the written agreement instead. That submission, in effect, asks this court not to give effect to the intention of the parties. Such a submission is contrary to the classical theory of contract interpretation which emphasizes that courts should ascertain and give effect to the intention of the parties: R. Sullivan, "Contract

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[48] *Housen v. Nikolaisen*, 2002 S.C.C. 33 at para. 36, [2002] 2 S.C.R. 235 [*Housen*].
[49] *Sattva Capital Corp. v. Creston Moly Corp.*, 2014 S.C.C. 53 at para. 49 [*Sattva*].
[50] McCann Motion Factum, Responding Compendium, Tab 16, at para 57.
[51] *Shelanu Inc. v. Print Three Franchising Corporation* (2003), 64 O.R. (3d) 533 (Ont. C.A.) [*Shelanu*].

> Interpretation in Practice and Theory" (2000) 13 S.C.L.R. (2d) 369.
>
> Sullivan states, at p. 378, that, "if a conflict arises between the intention of the parties as inferred from the totality of the evidence on the one hand and the meaning of the text on the other, intention should win." Professor Waddams has also argued that if a party knows or has reason to know that a written contract on which the party relies does not represent the intention of the other party, it should not be enforced. See S.M. Waddams, The Law of Contracts, 3rd ed. (Toronto: Canada Law Book, 1993) at paras. 328-9.[52]

44. This analysis is particularly important in an insolvency scenario, where the interests of various stakeholders may be affected by the interpretation of the relationship between the debtor and an individual creditor. The substance must prevail over the form of the arrangement and parties cannot be allowed to take the benefits of written agreements that were not followed.[53]

45. The legal principles involved on this appeal are inextricably tied to the facts of the case. The court was asked to determine if property was owned by certain parties based upon equitable principles, in light of the particular facts of this case. The court was also asked to determine if a debtor/creditor relationship existed based upon a number of indicia to be selected and applied on a case-by-case basis. There is no rule requiring that the same indicia be applied in all cases; the determination of the appropriate indicia is made based upon the relevant facts of the particular case.

46. Of all of the indicia of different types of relationships, Justice Morawetz focused on three generally accepted indicia of a debtor/creditor relationship that he found were applicable in this case – namely the payment of interest, the risk of loss of property and the commingling of the disputed assets – to determine that the TPLs were not owners of

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[52] *Shelanu, supra* at paras. 54-56.
[53] *Smith Brothers Contracting Ltd (Re)* (1998), 53 B.C.L.R. (3d) 264 at para. 26.

the TPL Funds and that a debtor/creditor relationship was in place. These general principles are supported by the authorities cited above.

47. As no question of law is at issue on this appeal and it is clear that any applicable legal principles are inextricably tied to the facts of the case, any question on the appeal must be a question of fact or mixed fact and law. As such, the appropriate standard of review is one of palpable and overriding error.

iv. No Palpable or Overriding Error

48. The palpable and overriding error standard addresses both the nature of the factual error and the impact on the result.[54] The role of the appellate court is to review the reasons of the court below in light of the arguments of the parties and the relevant evidence, and then to uphold the decision of the court below unless a palpable error leading to a wrong result has been made by the trial judge.[55]

49. One objective of this standard of review is limitation on the intervention of appellate courts to cases where the result can be expected to have an impact beyond the parties to the particular dispute. It reflects the role of courts of appeal in ensuring the consistency of the law, rather than in providing a new forum for parties to continue their private litigation.[56]

50. The high standard of palpable and overriding error for questions of fact or questions of mixed fact and law must be applied with the above purposes in mind, particularly in a case such as this one that deals with unique and likely non-recurring facts concerning the nature of a relationship between very particular parties. Moreover, that high standard is reinforced by the fact that these issues have been the subject of

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[54] *Waxman v. Waxman* (2004), 44 B.L.R. (3d) 165 at para. 295 (Ont. C.A.) [*Waxman*].
[55] *Housen, supra* at para. 4.
[56] *Sattva, supra* at paras. 51 and 52.

several appearances before Justice Morawetz in a CCAA proceeding, in which a judge exercising a supervisory function is owed considerable deference.[57]

51. A "palpable" error is one that is obvious, plain to see or clear.[58] An appellate court should only intervene if the finding is clearly wrong, unreasonable or unsupported by evidence.[59]

52. An overriding error is an error that is sufficiently significant to vitiate the challenged decision. Where the challenged decision is based on a broad collection of determinations, the conclusion that one or more of those determinations is founded on a "palpable" error does not automatically mean that the error was also overriding. The appellant must demonstrate that the error goes to the root of the challenged determination such that the determination cannot safely stand in the face of that error.[60]

53. Justice Morawetz made no palpable error in arriving at his conclusion; the decision was not clearly wrong, unreasonable or unsupported by evidence.

54. Even if Justice Morawetz did make a palpable error, such error was not overriding. Justice Morawetz's decision is based on a collection of factual findings, any of which supports his ultimate conclusion that Cash Store was in a debtor/creditor relationship with the TPLs, and that no ownership or trust arrangement was present on the facts.

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[57] *Canadian Union of Public Employees, Locals 1712, 3009, 2225-05, 2225-06 and 2225-12 v. Royal Crest Lifecare Group Inc. (Trustee of)* (2004), 46 C.B.R. (4th) 126 at para 23 (Ont. C.A.).
[58] Examples include findings made in the complete absence of evidence, findings made in conflict with accepted evidence, findings based on a misapprehension of evidence and findings drawn from primary facts that are the result of speculation rather than inference: *Waxman, supra* at para. 296.
[59] *H.L v. Canada (Attorney General)*, 2005 S.C.C. 25 at paras. 55 and 56, [2005] 1 S.C.R. 401.
[60] *Waxman, supra* at para. 297.

B. No novation of contract

i. The written contract was never performed

55. Justice Morawetz properly determined that his task was to evaluate the factual circumstances based on a variety of indicia including: the commingling of funds, the payment of interest, and the lack of any of the risks of ownership of the purported property. As explained above, this was an exercise in characterization.

56. Justice Morawetz was not concerned with whether the parties had altered their relationship and their mutual obligations in the midst of performing those obligations. Instead, Justice Morawetz considered what the relationship had been in practice all along, based on various facts in existence since the beginning of the relationship, including:

(a) the commingling of TPL Funds in Cash Store's accounts;[61]

(b) the fact that Cash Store provided a rate of return equivalent to 17.5% per annum to the TPLs and Cash Store made "voluntary payments" to the TPLs in this amount;[62] and

(c) 59% interest payments were never expected to flow through to the TPLs.[63]

57. Justice Morawetz found that the strict brokerage relationship described in the Broker Agreements was never carried out – "in reality, this did not happen."[64]

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[61] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 122.
[62] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 124.
[63] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 125.
[64] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 123.

58. The Appellants claim that Justice Morawetz erred (in law or mixed fact and law) by improperly interpreting and applying the legal test for imposing on parties a new contract fundamentally different from the written contract agreed to by the parties. The cases cited by the Appellants are ones in which courts have presumed that parties intended to rescind an earlier contract and replace it with a subsequent one. However, Justice Morawetz did not presume that the Broker Agreements had been rescinded and replaced. To the contrary, he indicated that he reached the conclusion "that the parties did **alter** the relationship from what was set out in the Broker Agreements,"[65] and that the "non-waiver" clause did not bar the parties from choosing to "**modify** their arrangements subsequent to the execution of the Broker Agreement."[66]

59. It is settled law that parties may, by their conduct, vary the terms of a written agreement.[67] In *Hyslip v MacLeod Savings & Credit Union Ltd*, a credit union repeatedly increased the interest rates it charged its borrowers beyond specified limits set out in written credit agreements, after providing notice of each change to its borrowers. The Alberta Court of Queen's Bench found, as a question of fact, that a borrower accepted these variations to the contract by continuing to make his interest payments, on full notice of the change in rate and without protest:

> Macleod Savings started the process of variation by unilateral acts on its part with express notice to Hyslip. I am completely satisfied, and it is a fair and reasonable inference to be drawn from Hyslip's conduct thereafter, in fact in my view it is the only fair inference that can be drawn from his conduct, and I find this as a fact, that Hyslip accepted and consented to what Macleod Savings had done.[68]

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[65] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 127 [emphasis added].
[66] Morawetz Endorsement, Responding Compendium, Tab 1, at para. 128 [emphasis added].
[67] *Hyslip v. Macleod Savings & Credit Union Ltd.*, [1988] A.J. No. 642 at 14.
[68] *Hyslip, supra* at 18.

60. The Court expressly stated that the modified arrangement between the parties was not a "new agreement, but a variation of a term in the original agreements."[69]

61. In a comparable case, *Bird Construction Co. v. Theo C. Ltd.*,[70] the Manitoba Court of Queen's Bench found that a building owner could not rely on a contract provision requiring construction delays to be approved by a consultant where the parties had, by conduct, varied their project protocol by having progress meetings instead of providing information to the consultant.[71]

62. In such situations, as in the present case, the written contract is not discarded. The fact that the parties' conduct may alter the extent to which a party may rely on certain aspects of a contract does not set aside the written agreement in its entirety. Justice Morawetz recognized this in relying on *Barclays Bank PLC v Devonshire Trust (Trustee of)* for the principle that parties may waive their contractual rights by election notwithstanding the presence of a "non-waiver" clause.[72]

63. Simply put, Justice Morawetz made factual findings as to the nature and substance of the relationship between the parties, which he found differed from the strict words of the Broker Agreements. While the Broker Agreements contemplated that the parties could have established a trust relationship, the TPLs never took advantage of these mechanisms. Justice Morawetz made no finding that the parties had intended to replace the Broker Agreements with entirely different agreements. Instead, he found that the true nature of the relationship, which varied from what was contemplated by the Broker Agreements but was confirmed by the conduct of the parties, was one of debtor and creditor.

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[69] *Hyslip, supra* at 17-18.
[70] 2006 M.B.Q.B. 61 [*Bird*]; aff'd 2007 M.B.C.A. 17.
[71] *Bird, supra* at paras 17-18, 30 and 49.
[72] Morawetz Endorsement, Responding Compendium, Tab 1, at paras. 128-129, citing *Barclays Bank PLC v. Devonshire Trust (Trustee of)*, 2011 ONSC 5008 at para 232.

ii. Pattern of conduct supports Justice Morawetz's conclusions

64. Even if the result of Justice Morawetz's decision was to find that the parties had abandoned the terms of the Broker Agreements in their entirety, the evidence before the court amply supported such a conclusion.

65. Justice Morawetz's reasons are based very much on the pattern of conduct of the parties. His reasons make repeated reference to how the relationship between Cash Store and the TPLs functioned in practice, and how the continued conduct of the parties indicated that they had altered their relationship from the strict language of the Broker Agreements.[73]

66. The Appellants attempt to marginalize these findings by describing them as related only to certain aspects of the parties' conduct, as opposed to conduct that evinces the parties' intention to abandon the terms of the Broker Agreements. But the factual findings on which Justice Morawetz relied all related to the most fundamental aspect of the relationship – namely, the absence of trust arrangements and the payment of proceeds by Cash Store to the TPLs. If indeed it is the case that the parties had decided to replace the written contract with an entirely new agreement, Justice Morawetz had sufficient justification to come to this conclusion given his factual findings related to the pattern of conduct of the parties.

67. Justice Morawetz therefore made no palpable or overriding error in respect of the nature of the actual relationship that existed between Cash Store and the TPLs.

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[73] See, for example, Morawetz Endorsement, Responding Compendium, Tab 1, at paras 123-125.

C. No misapprehension of evidence

68. The TPLs insist that Justice Morawetz ascribed unduly little weight to certain facts that assist them, including the strict language of the Broker Agreements and representations made by Cash Store in its financial disclosure regarding its relationship with the TPLs. At the same time, as discussed in more detail below, the TPLs claim that Justice Morawetz gave too much credence to certain other factors that he found militated against the TPLs' claim of ownership over the TPL Funds.

69. The CCAA judge is entitled to consider the nature of parties' dealings with a debtor in order to determine the character and viability of those claims. In performing this review, Justice Morawetz's emphasis on the importance of different portions of the evidence than the TPLs would have preferred is not a palpable and overriding error. The law is clear that a judge's failure to discuss a relevant factor in depth, or even at all, is not itself a sufficient basis for an appellate court to reconsider the matter. The failure to discuss a relevant factor is only relevant if that failure gives rise to a reasoned belief that the trial judge must have forgotten, ignored or misconceived the evidence in a way that affected his conclusion.[74]

i. Commingling of Funds

70. Whether funds were commingled, and what the parties knew about segregation of funds, was subject to conflicting evidence on the motion below.

71. Cash Store's evidence was that the TPLs never took advantage of protections available to them to ensure that the TPL Funds were segregated, and so Cash Store commingled TPL Funds with its operating cash.[75] In response, the TPLs claimed that

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[74] *Housen, supra* at para. 39.
[75] Affidavit of Steven Carlstrom sworn April 14, 2014, Responding Compendium, Tab 9, at para 79.

they had always been under the impression that the TPL Funds were segregated from Cash Store's operating cash,[76] notwithstanding the July 23, 2012 e-mail from a Cash Store representative that expressly explained that all accounts had been combined and that there would be no Designated Broker Bank Accounts in connection with the new form of Broker Agreements.[77]

72. It was open to Justice Morawetz to make findings not only on these contested facts but also the credibility of witness testimony on this subject. Ultimately, he determined that the TPL Funds had been commingled with Cash Store funds, but made no finding on whether or not the TPLs were aware of or agreed to the commingling of TPL Funds.

73. The factual finding – regardless of the issue of knowledge – that TPL Funds had been commingled with Cash Store's operating funds speaks to the question of whether the TPL Funds were beneficially owned by the TPLs. The Appellants had argued on the motion below that the segregation of funds was a key indicia of ownership. According to the TPLs, since the TPL Funds were segregated, or were supposed to be segregated, the TPLs owned the TPL Funds. For example, Trimor argued as follows:

> The Trimor Funds were segregated with all funds received from third party lenders and accounted for as restricted cash. As a result, the Applicant's creditors and other stakeholders could always discern from public sources the amount of Trimor Funds that were deployed as loans to Customers or held as a float for future loans.[78]

74. Similarly, McCann claimed that segregation of its funds indicated that it owned those funds:

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[76] Affidavit of Sharon Fawcett sworn April 22, 2014, Responding Compendium, Tab 8, at para 3.
[77] E-mail from Michael Zvonkovic dated July 23, 2012, Responding Compendium, Tab 12.
[78] Trimor Motion Factum, Responding Compendium, Tab 17, at para 47.

> As with the indicia of ownership from *BC Tel*, the true consignment indicia identified in *Access Cash* strongly militate for interpreting the Broker Agreement as creating a relationship pursuant to which McCann retained ownership of the McCann Property at all material times. McCann has the contractual right to demand the return of the McCann Funds, and Cash Store was required to hold the McCann Funds in a segregated account and to account for those funds separately.[79]

75. Justice Morawetz's reasons on the commingling issue speak directly to this argument:

> [T]he determining fact is that the Funds were co-mingled with Cash Store funds in the operating account. As such, regardless of what the TPLs believed, there was one account and it is not possible to identify the source of the funds.[80]

76. These findings simply weakened the TPLs' argument that they owned the TPL Funds, and supported the ultimate conclusion that the parties were in a debtor/creditor relationship. Justice Morawetz made no error in his factual findings and conclusions with respect to the commingling issue.

ii. Retention Payments

77. There was also conflicting evidence regarding the nature of the various types of compensation provided by Cash Store to the TPLs.

78. The Appellants noted statements made by Cash Store representatives in this matter and in public disclosure describing the monthly retention payments as "voluntary" and intended to induce the TPLs into continuing to make funds available to Cash Store.[81] Similarly, the Appellants relied on descriptive evidence from witnesses to

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[79] McCann Motion Factum, Responding Compendium, Tab 16, at para 65.
[80] Morawetz Endorsement, Responding Compendium, Tab 1, at para 122.
[81] See McCann Appeal Factum at para. 52.

argue that the TPLs always bore the risk of their own loan portfolios, despite Cash Store's capital protection scheme and the continuous retention payments.[82]

79. Justice Morawetz also had to consider the hard data, which stood in direct conflict with these arguments. The data demonstrated that the TPLs received monthly cash payments equal to 17.5% annual interest, regardless of the performance of the underlying loan assets. For example, a snapshot of the earnings data for McCann between September 2013 and February 2014 shows that the only variation between payments is attributable to the number of days in a given month:[83]

Period	Amount Advanced	Interest Rate	Days in Month	Monthly Payment
September 2013	$13,500,000	17.5%	30	$192,020.55
October 2013	$13,500,000	17.5%	31	$198,421.23
November 2013	$13,500,000	17.5%	30	$192,020.55
December 2013	$13,500,000	17.5%	31	$198,421.23
January 2014	$13,500,000	17.5%	31	$198,421.23

80. As this sample demonstrates, the TPLs received fixed returns from Cash Store that were never affected by their supposed link to risky underlying payday loans. The fact that the principal advances never eroded indicates that the TPLs were insulated from the credit risk of actual payday lending. After considering the relationship in its entirety, Justice Morawetz found that the financial data, which showed expected monthly payments of 17.5% interest, garnered more weight than conjecture from witnesses. As a result, he found that the relationship in practice was one of debtor and creditor. There was no error in this approach.

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[82] McCann Appeal Factum at para. 54.
[83] McCann Lender Disbursement Summary, March 2014 (CH0001836), Responding Compendium, Tab 14.

D. No unfair treatment compared to the *BIA*

81. Finally, the TPLs claim, as they did in passing on the motion below, that Justice Morawetz's reasons on the motion below are inconsistent with Part XII of the *Bankruptcy and Insolvency Act*, which considers the dissipation of assets on the insolvency of securities brokerage firms.

82. The TPLs assert that, since it would be an error of law for the court to allow an insolvent securities brokerage to satisfy its debts using its clients' property, it is accordingly an error of law for Cash Store to be permitted to use TPL property to finance its restructuring or pay its creditors.

83. However, the TPLs also acknowledge that the *BIA* does not apply to the present case, and that these arguments regarding Part XII of the *BIA* only apply by analogy.

84. Part XII of the *BIA* was designed to deal specifically with issues arising from the unique needs of a bankruptcy of a securities firm and there is no reason to think that the principles in Part XII should apply to any other industry.

85. Further, the TPLs' argument on this point presupposes that the relationship between the TPLs and Cash Store is a brokerage relationship. Justice Morawetz found instead that the relationship between the parties, based on the entirety of the circumstances, was that of debtor and creditor, as explained at length above.

86. It should also be recalled that, with a securities brokerage, the clients pay the broker for the service of managing invested funds. By contrast, in the present case, the TPLs never paid Cash Store for its money management services – rather, Cash Store paid the TPLs a fixed amount of money each month to cause the TPLs to continue to

make the TPL Funds available for Cash Store to lend to customers. This distinction makes any link to Part XII of the *BIA* even more tenuous.

87. Justice Morawetz therefore made no error in disregarding the TPLs' claims of unfair treatment in this respect.

PART IV - RELIEF SOUGHT

88. Based on all of the foregoing, the Respondents respectfully request that these appeals be dismissed with costs payable to the Respondents.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 1st day of October, 2014.

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SCHEDULE A
LIST OF AUTHORITIES

1 *Henry v. Hammond*, [1913] 2 K.B. 515.

2 *General Publishing Co. (Re)* (2002), 34 C.B.R. (4th) 186.

3 *Water Street Pictures Ltd. v. Forefront Releasing Inc.,* 2006 B.C.C.A. 459.

4 *Giles v. Westminster Savings Credit Union,* 2006 B.C.S.C 141.

5 *Housen v. Nikolaisen,* 2002 S.C.C. 33, [2002] 2 S.C.R. 235.

6 *Sattva Capital Corp. v. Creston Moly Corp.,* 2014 S.C.C. 53.

7 *Shelanu Inc. v. Print Three Franchising Corporation* (2003), 64 O.R. (3d) 533 (Ont. C.A.).

8 *Smith Brothers Contracting Ltd (Re)* (1998), 53 B.C.L.R. (3d) 264.

9 *Waxman v. Waxman* (2004), 44 B.L.R. (3d) 165 (Ont. C.A.).

10 *Canadian Union of Public Employees, Locals 1712, 3009, 2225-05, 2225-06 and 2225-12 v. Royal Crest Lifecare Group Inc. (Trustee of)* (2004), 46 C.B.R. (4th) 126 (Ont. C.A.).

11 *H.L v. Canada (Attorney General),* 2005 S.C.C. 24, [2005] S.C.R. 401.

12 *Hyslip v. Macleod Savings & Credit Union Ltd.,* [1988} A.J. No. 642.

13 *Bird Construction Co. v. Theo C. Ltd.,* 2006 M.B.Q.B. 61; aff'd 2007 M.B.C.A. 17.

14 *Barclays Bank PLC v. Devonshire Trust (Trustee of),* 2011 ONSC 5008.

15 Donovan Waters, Mark Gillen & Lionel Smith, *Waters' Law of Trusts In Canada,* 4th ed. (Toronto: Thomson Reuters Canada Limited, 2012).

16 A.H. Oosterhoff et al, *Oosterhoff on Trusts: Text, Commentary and Materials,* 6th ed. (Toronto: Thomson Canada Limited, 2004).

SCHEDULE B
RELEVANT STATUES

N/A

IN THE MATTER OF The Cash Store Financial Services Inc., *et al.*

Applicants

Court of Appeal File No: M44123
M44124

COURT OF APPEAL FOR ONTARIO
Proceeding commenced at Toronto

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