Court File No. CV-14-1051800CL

ONTARIO
SUPERIOR COURT OF JUSTICE
COMMERCIAL LIST
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., INTSALOANS INC., 7252331 CANADA INC., 5515433 MANITOBA INC., 1693926 ALBERTA LTD DOING BUSINESS AS "THE TITLE STORE"

BOOK OF AUTHORITIES OF THE RESPONDENT, 0678786 B.C. LTD. (FORMERLY THE MCCANN FAMILY HOLDING CORPORATION)

Dated: April 25, 2014

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Tab 1

1996 CarswellOnt 5566
Ontario Court of Justice (General Division)

United States v. Friedland

1996 CarswellOnt 5566, [1996] O.J. No. 4399

U.S.A, Plaintiff and Robert Friedland, Defendant

Sharpe J.

Heard: October 22-31, 1996
Judgment: November 5, 1996
Docket: 96-CU-109731

Counsel: *Malcolm Ruby*, *R. Stephenson*, for Plaintiff
Alan Lenczner, *Howard Shapray*, for Defendant

Subject: Civil Practice and Procedure; International; Insolvency

***Sharpe J.*:**

1 HIS HONOUR: This motion arises from a claim by the United States of America for reimbursement for the costs of restoring environmental harm alleged to have resulted from a mining operation at Summitville in the State of Colorado. The claim is being pursued by the Environmental Protection Agency under the governing U.S. statute, the *Comprehensive Environmental Response Compensation and Liability Act (CERCLA)* in the United States District Court for the District of Colorado.

2 The United States alleges before this Court that the Defendant Robert Friedland has no assets in the United States. It intends to enforce in Ontario the judgment it hopes to obtain in the District Court. On August 21st, 1996, the United States obtained from the Court an *ex parte* injunction freezing U.S.$152 million worth of shares owned by the Defendant Friedland. As the United States proceeded *ex parte*, the Defendant was not heard by the Court before that order was granted.

3 The question before me on this contested motion is whether the United States is entitled to this injunction.

4 While the background facts are complex, for the purposes of this judgment, they might be summarized as follows:

5 The claim concerns the Summitville mine site which has been the subject of mining operations for over 100 years. The claim focuses on the activities of the Defendant Friedland in connection with three companies, Summitville Consolidated Mining Company (SCMCI), its parent company Galactic Resources Inc. (GRI), and GRI's parent Galactic Resources Limited (GRL).

6 From 1984 until 1992, SCMCI operated an open pit heap leach gold mine at Summitville. The construction of this mine commenced in October of 1984 and extended to October of 1986. Production began in June of 1986.

7 The heap leach process involves strip-mining ore from open pits. The ore is then crushed and heaped onto a synthetic pad known as the "heap leach pad". A solution containing sodium cyanide is sprayed over and allowed to percolate through the crushed ore to leach out the gold. That solution is processed. The gold is removed. The solution is rejuvenated and recycled. Waste ore is placed on a dump site.

8 The United States alleges that there have been serious leakage problems with the leach pad from the beginning; that there are serious problems with acid mine drainage which have posed environmental hazards.

9 It is clear that SCMCI experienced economic difficulties. On December 4, 1992, the company filed for bankruptcy and shortly thereafter abandoned the site. The EPA conducted an investigation which revealed what it alleges is a serious situation relating from failing equipment and treacherous weather conditions; and since December 15, 1992, the EPA has been involved with restoration activities connected with this mine site.

10 The Defendant Friedland was a co-founder of GRL and was president of that company from January 1981 to June of 1984 when Edward Roper became president and Friedland became GRL's chief executive officer. Friedland again served as interim president in June of 1987 when Roper left the company. He held that position until June of '90 when Peter Guest was hired as president. Friedland was the chairman of the board of GRL from June of 1984 and served as a director until his resignation on November 2nd, 1990. Friedland was also president of SCMCI from August, 1984 to January, 1987. He also served as a director of that company and as president of GRI from 1984 until January, 1987.

11 The governing section of *CERCLA*, section 107 enables the United States to recover cleanup costs incurred by the Environmental Protection Agency from parties responsible for contamination. To establish liability, four elements must be satisfied:

(a) that the subject is a "facility";

(b) that "release" or "threatened release" has taken place or will take place;

(c) that the release or threatened release has caused the plaintiff to incur response costs; and

(d) that the defendant falls within at least one of the four classes of responsible persons described in the section.

12 One of the classes described is "any person who at the time of disposal of any hazardous substance owned or operated any facility at which such hazardous wastes were disposed of".

13 The key issue that has been argued before me relates to the question of whether the U.S.A. has a strong *prima facie* case that Robert Friedland operated the facility within the meaning of that statute.

14 It is the contention of the Plaintiff United States that, by reason of his involvement with the affairs of the companies I have mentioned, he is personally liable as an operator.

15 The United States initiated proceedings against Friedland in the United States District Court of Colorado on May 23rd, 1996, claiming reimbursement for response costs incurred to date and projected in the amount of U.S.$152 million.

16 Immediately, the United States brought three *ex parte* applications which were heard *in camera* at the request of the United States.

17 First, the United States sought and obtained from District Court Judge Nottingham an *ex parte* garnishment order under the *Federal Debt Collection Procedure Act*. That was granted on May 23rd, 1996. Judge Nottingham also granted an order sealing the file.

18 On May 27th, 1996, the United States brought a motion in the Supreme Court of British Columbia for an *ex parte Mareva* injunction. A similar motion was brought before this Court on May 29th. In both the British Columbia Court and this Court, the order sought was for an injunction restraining the Defendant Friedland from dissipating, disposing or, alienating, encumbering, removing, or otherwise dealing with, INCO Limited share certificates having an aggregate market value of U.S. $152 million pending disposition of the proceedings brought against the Defendant in the United States District Court for the District of Colorado.

19 When those motions were brought, the Plaintiff understood that a transaction between a company in which Friedland holds substantial interests, Diamond Fields Resources Inc. and INCO would close within days and that as a result of that transaction Friedland would acquire a substantial volume of INCO shares.

20 The transaction did not close in May as expected for factors not connected to this proceeding. The Plaintiff had argued the *ex parte* motion before Justice Spencer in the British Columbia Supreme Court and he had reserved judgment. At the Plaintiff's request, that motion was adjourned *sine die*. Similarly, the motion brought in this Court before Judge Borins was adjourned *sine die*.

21 The Defendant Friedland was not served with any of these proceedings.

22 When the Plaintiff learned in the month of August that the transaction was expected to close on August 21st, it renewed the B.C. Motion. On August 20th, Justice Spencer granted the *Mareva* injunction and gave oral reasons.

23 The motion before Judge Borins was renewed and on August 21st, 1996, Judge Borins adopted the reasons of Justice Spencer and granted the injunction in Ontario. The Defendant Friedland was then served. The Plaintiff moved to continue the injunction. The order was continued by an order of Justice Borins on August 28th and further continued by me on September 6th, when a timetable for dealing with the contested motion was established.

24 The motion has been fully argued before me over eight days. Four broad issues have been presented:

1. Did the Plaintiff make full and frank disclosure of the case when it sought the *ex parte Mareva* injunction? If it did not, what are the consequences?

2. Has the Plaintiff established that it has a strong *prima facie* case on the merits against the Defendant?

3. Did this Court have jurisdiction to order injunctive relief in support of the action in the U.S. District Court?

4. Is it necessary for the Plaintiff to show that the Defendant intends to remove assets from Ontario for the purpose of avoiding execution or is it sufficient to show that there is a risk of removal that will have that effect?

25 The complexity of the issues and the extensive nature of the argument presented by the parties would ordinarily require written reasons. However, in my view, the interests of justice require an immediate response and hence I am delivering these oral reasons today. I turn to the first issue:

Did the Plaintiff make full and frank disclosure of the case when it sought the ex parte Mareva injunction?

26 It is a well established principle of our law that a party who seeks the extraordinary relief of an *ex parte* injunction must make full and frank disclosure of the case. The rationale for this rule is obvious. The Judge hearing an *ex parte* motion and the absent party are literally at the mercy of the party seeking injunctive relief. The ordinary checks and balances of the adversary system are not operative. The opposite party is deprived of the opportunity to challenge the factual and legal contentions advanced by the moving party in support of the injunction. The situation is rife with the danger that an injustice will be done to the absent party. As a British Columbia judge noted recently:

> There is no situation more fraught with potential injustice and abuse of the Court's powers than an application for an *ex parte* injunction.

(*Watson v. Slavik*, August 23rd, 1996, paragraph 10.)

27 For that reason, the law imposes an exceptional duty on the party who seeks *ex parte* relief. That party is not entitled to present only its side of the case in the best possible light, as it would if the other side were present. Rather, it is incumbent on the moving party to make a balanced presentation of the facts in law. The moving party must state its own case fairly and must inform the Court of any points of fact or law known to it which favour the other side. The duty of full and frank disclosure

is required to mitigate the obvious risk of injustice inherent in any situation where a Judge is asked to grant an order without hearing from the other side.

28 If the party seeking *ex parte* relief fails to abide by this duty to make full and frank disclosure by omitting or misrepresenting material facts, the opposite party is entitled to have the injunction set aside. That is the price the Plaintiff must pay for failure to live up to the duty imposed by the law. Were it otherwise, the duty would be empty and the law would be powerless to protect the absent party.

29 These principles are so well established in the law that it is hardly necessary to cite supporting authority. They find expression in the Rules of Court. Rule 39.01(6) provides:

> Where a motion or application is made without notice, the moving party or applicant shall make full and fair disclosure of all material facts, and failure to do so is in itself sufficient ground for setting aside any order obtained on the motion or application.

30 The principle has been affirmed and reaffirmed by judicial decision. In the leading Ontario case on *Mareva* injunctions, *Chitel v. Rothbart* (1982) 39 OR 2d 513, a judgment of the Court of Appeal, Associate Chief Justice MacKinnon stated, at page 519:

> There is no necessity for citation of any authority to state the obvious that the plaintiff must, in securing an *ex parte* interim injunction, make full and frank disclosure of the relevant facts, including facts which may explain the defendant's position if known to the plaintiff. If there is less than this full and accurate disclosure in a material way or if there is a misleading of the court on material facts in the original application, the court will not exercise its discretion in favour of the plaintiff and continue the injunction.

31 The duty of full and frank disclosure is, however, not to be imposed in a formal or mechanical manner. *Ex parte* applications are almost by definition brought quickly and with little time for preparation of material. A plaintiff should not be deprived of a remedy because there are mere imperfections in the affidavit or because inconsequential facts have not been disclosed. There must be some latitude and the defects complained of must be relevant and material to the discretion to be exercised by the Court. (See *Mooney v. Orr*, (1994) 100 B.C. L.R 2d 335; *Rust Check v. Buchowski* (1994) 58 CPR 3d 324.

32 On the other hand, a *Mareva* injunction is far from a routine remedy. It is an exception to the basic rule that the Defendant is entitled to its day in court before being called upon to satisfy the Plaintiff's claim or to offer security for the judgment. This is clear from the decision in *Chitel v. Rothbart, supra.* It was emphasized by the decision of the Supreme Court of Canada in *Aetna Financial Services v. Feigelman*, [1985] 1 S.C.R. 2, where Justice Estey referred to what he described as "the simple proposition that in our jurisprudence, execution cannot be obtained prior to judgment and judgment cannot be obtained prior to trial".

33 Justice Estey went on to say:

> There is still ... a profound unfairness in a rule that sees one's assets tied up indefinitely pending a trail of an action which may not succeed, and even it does succeed, which may result in an award far less than the caged assets.

34 Justice Estey stated as well:

> A plaintiff with an apparent claim, without ultimate substance, may, by the *Mareva* exception to the *Lister* rule, tie up the assets of the defendant, not for the purpose of their preservation until judgment, but to force, by litigious blackmail, a settlement on the defendant who, for any one of many reasons cannot afford to await the ultimate vindication after trial.

35 For this reason, it has been said that respect for the duty of full and frank disclosure is especially important with respect to *Mareva* injunctions because, by their very nature, they are liable to cause substantial prejudice to the defendant. (See the leading English text, *Gee, Mareva Injunctions and Anton Piller Relief* (3d Edition 1995 at p. 97).

36 It is also clear from the authorities that the test of materiality is an objective one. Again to quote the *Gee* text at page 98:

> ...The duty extends to placing before the court all matters which are relevant to the court's assessment of the application, and it is no answer to a complaint of non-disclosure that if the relevant matters had been placed before the court, the decision would have been the same. The test as to materiality is an objective one, and it is not for the applicant or his advisers to decide the question; hence it is no excuse for the applicant subsequently to say that he was genuinely unaware, or did not believe, that the facts were relevant or important. All matters which are relevant to the 'weighing operation' that the court has to make in deciding whether or not to grant the order must be disclosed.

37 This principle is affirmed by decisions in Canada. (See *Leung v. Leung*, [1993] 77 B.C.L.R. (2d) 305 at 313; *Canadian Pacific Railway v. United Transportation Union* [1970] 14 DLR (3d) at 497; and *Panzer v. The Queen*, [1990] 74 OR (2d) 130.

38 I turn then to consider the material that was before Justice Borins when he was asked to give the order.

39 The principal affidavit filed by the United States of America was that of Nancy Mangone. She is described as a member of the Bars of New York, Colorado and the District of Columbia. She is currently an enforcement attorney in the Legal Enforcement Program of the United States Environmental Protection Agency, Regional Office in Denver. She has extensive experience in the area of environmental law and she describes herself as the EPA's lead counsel in relation to the Summitville site.

40 The affidavit of Nancy Mangone attaches, as exhibits, the record of the *ex parte* proceedings before Judge Nottingham. This includes another affidavit from Mangone and supporting affidavits and four volumes consisting of hundreds of pages of documents gathered by the EPA in its investigative efforts.

41 There are also various other exhibits including an affidavit of another lawyer, Lisa Friedman, which had been prepared for another Ontario case dealing with the *CERCLA* statute and liability.

42 There are also attached press releases issued by the Defendant Friedland and a newspaper article purporting to set out his position, and the INCO proxy circular which described the INCO/Diamond Fields transaction.

43 Those are the principal items.

44 In addition, there were two factums before Judge Borins, summarizing the Plaintiff's position on the evidence and the law. The first factum was filed originally in May and consisted of some 30 pages. The second factum was filed for the August hearing and it was longer, 37 pages, and focused on the legal point regarding the jurisdiction of the Court.

45 The Mangone affidavit is some 33 pages and it sets out what purport to be various factual assertions concerning the site, the operations, the alleged problems, the alleged environmental harms that have resulted, the alleged involvement of Friedland in those problems and in those companies, the basis for the injunction including the whereabouts of Friedland, and certain details regarding the INCO/Diamond Fields transaction.

46 Ms Mangone also offers her legal opinion. As the U.S. law applicable to this case is foreign law it had to be proved as a matter of fact. She offers the opinion that the United States has a strong *prima facie* case against the Defendant Friedland. I will be considering in some detail the Mangone affidavit but note here that the propositions asserted in the affidavit purport to be supported by references to tabs in the U.S. record and, in many cases, these references are general in nature, offering a long list of documents in that record.

47 The Deponent Nancy Mangone was cross-examined, and on her cross-examination certain claims of privilege were raised with respect to background documents that had not been included in the record. Those claims of privilege were based on solicitor/client privilege, litigation privilege and administrative deliberative privilege under U.S. law.

48 A motion was brought before me to determine the validity of that claim of privilege. In written reasons delivered on September 30, 1996, I found that the U.S.A. had waived privilege and I made an order, which in these proceedings has been called the "privilege order", declaring that Nancy Mangone cannot claim any privilege with respect to any documents that she

has seen or reviewed respecting the matters at issue. On the motion before me to continue the injunction, a significant amount of time was spent on documents which were disclosed pursuant to that order.

49 For the purpose of analyzing the non-disclosure contentions of the Defendant, I will review the complaints made under the following headings:

1. The explanation of applicable foreign law.

2. The factual case against Robert Friedland.

3. Quantum of the claim and availability of other remedies.

4. "Flight Risk".

5. Use and description of the proceedings before Judge Nottingham under the *Federal Debt Collection Procedure Act*.

6. Facts relating to the need for proceeding *ex parte*.

Explanation of applicable foreign law.

50 The Mangone affidavit refers to the affidavit of Lisa Friedman, filed in another case, and attached as an exhibit. Mangone then sets out the criteria for liability that I have already described. She deposes that, in her view, Friedland falls within one of the four classes of responsible persons. She says that in addition to reviewing the Friedman affidavit, she has conducted certain of her own legal research and on the basis of that, she deposes there exists a strong *prima facie* case that Friedland is an operator of the site.

51 While Mangone gives a long list of case citations, she provides no detail as to how she arrived at that opinion. The Friedman affidavit that she refers to gives somewhat more detail regarding the appropriate legal standard applicable to someone in the position of Friedland. Friedman's affidavit states as follows:

> U.S. Courts have also repeatedly held that *CERCLA* liability as an "owner or operator" may attach to individuals or corporations who exercise control over a site, even if title to the site is nominally held by a different corporate entity. Courts have imposed such liability as a matter of statutory construction distinct from "veil piercing" or other derivative liability theories.

52 On May 17th, 1996, a few days before Mangone swore the affidavit relied upon for the *ex parte* injunction, a document she had prepared, known as the "Referral Document", was sent by her supervisor to the U.S. Department of Justice. This is one of the documents produced following my order that privilege had been waived. It is clear from Mangone's cross-examination that the purpose of this document was to provide the Department of Justice with a candid assessment of the case against Robert Friedland so that the Department of Justice could determine whether it was appropriate to take the recommended proceedings against him. The Referral Document consisted of some 57 single-spaced typed pages and contains Mangone's detailed assessment of the relevant facts and law relating to the liability of Friedland.

53 In the Referral Document, Mangone is much more specific in her analysis of the applicable legal principles. She notes, significantly, as follows:

> Since this theory of liability will be a case of first impression in the Tenth Circuit, the standard the district court will adopt in determining an individual corporate officer's, director's or shareholder's liability is unknown.

54 I note that the U.S. District Court in Colorado is subject to the jurisdiction of the Tenth Circuit.

55 She then goes on to set out four tests that have been evolved by the Courts of the United States:

1. Piercing the corporate veil.

2. The capacity or authority to control corporate conduct.

3. The prevention test; and

4. Direct control over participation in wrongful conduct.

56 After reviewing those tests, she says of the fourth test, as follows:

> A variety of other courts, however, have adopted the fourth and final test of individual corporate officer, director or shareholder liability. This final test requires that the person actually participate in the operations or management of the facility or its hazardous waste disposal practices.

57 Then, again significantly in my view, she states that although the Tenth Circuit has yet explicitly to select one of these tests, a decision, *Colorado v. Idarado Mining Company* (18 Environmental Law Reports 20578) may be instructive on the Court's leaning. In that case, Mangone says:

> The Court held that a parent corporation would be liable for the acts of its subsidiary due to its "intimate involvement" with the subsidiary's business activities. This suggests this district may require some level of active involvement, rather than the mere authority to control the business activities of the company or to prevent the environmental harm in question.

58 Mangone then goes on to state that whatever test the Court applies, the approach the Courts have taken is a "heavily fact-specific inquiry". She then lists a number of criteria that the Courts have examined, which are as follows: the person's position in the company: degree of authority; percentage of ownership; role in decision-making and daily management; knowledge of and responsibility for waste disposal policies; and personal involvement with, neglect of, and ability to control hazardous waste matters.

59 It is difficult to understand why, if in order to provide the U.S. Department of Justice with a candid assessment of the case, it was necessary to explain these various legal theories that might apply and to explain that the Tenth Circuit might well adopt the strictest test, it was not also necessary to provide this Court with the same information. That strict test is surely stricter than that suggested by the Friedman affidavit, namely, that liability "may attach to individuals or corporations who exercise control over a site".

60 A subsequent affidavit from Friedman filed after the *ex parte* proceedings confirms that the final test requires that the person actually participate in the operations or management of the facility or its hazardous waste disposal practices.

61 In my view, there is a material difference between the description of the applicable legal test contained in the material before the *ex parte* Judge and the candid opinions offered in the Referral Document. The *ex parte* material describes a general control test. The candid opinion describes a more precise, more stringent test requiring proof of actual participation in the operations or management of the facility or its hazardous waste disposal practices.

62 A review of the cases cited in support of the stricter test have led me to the conclusion that it is far from evident that the U.S.A. will be able to bring Robert Friedland within that standard. In my view, it is no answer for the U.S.A. now to say that it thinks that Robert Friedland will be liable on any of these four tests.

63 In my view, it was incumbent on Mangone to give a fair and balanced statement of the applicable legal test, just as she did for the Department of Justice, so that this Court could assess for itself whether, on the facts she hoped to prove, the U.S.A. had a strong *prima facie* case. I find that this was a material fact which went to the heart of the case and that the failure to disclose her opinion that the District Court in Colorado could well apply the stricter test constituted a failure to disclose a material fact bearing upon the entitlement of the U.S.A. to the injunction it sought.

The factual case against Robert Friedland.

64 I note at the outset here that objection was taken to the admissibility of significant portions of the Mangone affidavit and attachments. It is clear that she is relating in her affidavit hearsay evidence and there is an issue as to the admissibility of that evidence. While that contention was raised during argument, I reserved ruling and permitted counsel for the U.S.A. to address the full and frank disclosure issue on the basis of all documentary evidence attached to the Mangone affidavit, as I felt that was only fair. I will turn to this point later in these reasons.

65 In the Mangone affidavit, she states that it is the contention of the United States of America that the Defendant Friedland personally made various decisions or instructed on-site personnel to conduct various practices that caused or contributed to the release of hazardous substances upon and from the site.

66 She goes on to depose to a plea bargain entered into by SCMCI on May 2nd, 1996 in which she states the company pleaded guilty to 40 felony counts, including one count of conspiracy and 30 counts of knowing unauthorized discharges of pollutants into the waters of the United States, and she attaches a copy of that plea bargain to her affidavit, indicating that the company agreed to pay $20 million for these criminal violations.

67 She further deposes to the bankruptcy of SCMCI on December 4, 1992; to the fact that the company indicated it would leave the site on December 15, 1992; that it was ordered not to abandon the site but that it did, in the event, abandon the site.

68 Then, in paragraph 37, which occupied a great amount of time during the argument, she sets out her factual contentions with relation to Mr. Friedland. She deposes that he:

> 1. held leadership positions in Galactic Ltd. as Chairman and CEO, and was president of SCMCI.
>
> 2. negotiated and executed the contract with the Anaconda Mining Company, under which Galactic Ltd. acquired the right to mine certain mining claims within the site and all of Anaconda's data regarding mining reserves, existing environmental conditions and potential environmental liabilities.
>
> 3. negotiated sources of financing for SCMCI, including the financial arrangements with the Bank of America.
>
> 4. had personal knowledge of potential environmental problems and liabilities that could result in going forward with the Summitville project.
>
> 5. had a primary role in decision-making for the design and installation of the leach pad liner.
>
> 6. negotiated numerous engineering and consulting contracts on behalf of the GRL-related corporate entitles. In particular, Friedland negotiated the contract for civil engineering and construction oversight services of Bechtel Civil Engineering & Minerals, Inc.
>
> 7. had the largest percentage of stock in Galactic owned by a private individual; Friedland controlled a large block of common stock in Galactic Ltd., particularly between 1983 and 1986, when the Summitville project was being financed, built, and brought into production. Friedland's percentage of the company amounted to 21.17 per cent at the end of 1983, 26 per cent in 1985, 17 per cent in 1985, and 10 per cent in 1986.
>
> 8. exerted substantial authority within and over Galactic Ltd./SCMCI corporate affairs. Executive Committee memoranda question whether Galactic Ltd. would be able to attract a new president to work "under the thumb" of Friedland and whether Friedland could "stop being involved with all aspects of operations". Friedland was also described as one of the "key personnel" in Galactic Ltd.'s filings with the United States Securities & Exchange Commission.
>
> 9. had personal knowledge of permit violations at the site.

69 The factum filed on the *ex parte* motion summarizes these factual contentions as follows:

> Friedland had pervasive control of, and influence over, Summitville. The Summitville project was primarily his idea and he promoted it vigorously. He negotiated and executed the contract with Anaconda through which Galactic acquired the rights to mine at the site. He negotiated sources of financing including arrangements with Bank of America. He had personal knowledge of potential environmental problems and liability that could result from going forward with the project. Indeed, he had a primary role in decision-making relating to the design and installation of the leach pad liner and, available evidence suggests, he well knew of problems yet pressed ahead despite the risks in order to meet production deadlines imposed under loans he had negotiated.

70 As I have noted, Justice Borins of this Court adopted the reasons reached by Justice Spencer and it is before me that the material before Justice Spencer was essentially the same material as before Justice Borins.

71 In his reasons for judgment, Justice Spencer in British Columbia concluded as follows:

> There is evidence put before me which raises in a substantial way the allegation that Summitville, Galactic, and the Plaintiff —

there he clearly meant "the Defendant" —

> as a directing mind of both, were aware from the beginning that the construction of the mine and its operation were done in so careless a manner that it posed the very threats to the environment that are now said to have materialized.

72 Ms Mangone has been subjected to several days of cross-examination; cross-examination which I have read. We have now had disclosure of the documents in the possession of the EPA, produced pursuant to the privilege order, and eight days of extensive argument.

73 On the basis of what I have read and heard, I am satisfied that Justice Spencer could not have come to that conclusion had he been given a fair statement of the evidence regarding Robert Friedland's involvement. Many of the facts, so-called, in the Mangone affidavit are little more than an expression of what she hopes to be able to persuade the Court. A careful review of the documents that she relies on indicates that she takes an excessively optimistic view of the case. They are far from facts; they are mere inferences that she purports to draw from this record.

74 In my view, the picture painted by this material offered by the United States was a misleading one. It suggests that Robert Friedland was effectively a one-man operation making all crucial decisions relating to the mine and its operations, and that is plainly not the case.

75 I am going to turn to the allegations that I have referred to from paragraph 37. The first significant contention relates to the leadership positions that Mr. Friedland held, and it is clear that much of the United States' case is based upon the simple fact that he exercised positions of authority in the companies concerned. What the Mangone affidavit did not disclose and what, in my view, were relevant facts, are the following:

76 First of all, GRL was a publicly traded company with the usual governing structure. It was not a one-man operation. The memorandum referred to in subparagraph 8 of 37, relating to Friedland's extensive and apparently unwarranted control of the company, was written not at the relevant period when the mine was being constructed but long after in March of 1990. Moreover, it is clearly an inadmissible hearsay document. The circumstances in which it was written are unknown and there is no indication that when the author said what he said, it had any direct bearing on the issues that are before this court.

77 Secondly, Mangone failed to make it clear in her affidavit that for the critical period 1984 to 1987, an experienced mining executive, Ed Roper, was the president of GRL and that the Defendant's position is that Mr. Roper had authority over all aspects of the construction.

78 Thirdly, Mangone failed to make it clear that Robert Friedland had left Summitville and these companies by 1990, two years prior to the bankruptcy and six years prior to the plea upon which she relied. It is clear that Friedland had nothing to do

with the bankruptcy, had nothing to do with the abandonment of the site and was in no way involved in the plea of guilty entered by SCMCI in 1996. Indeed, during the hearing, I ruled that that evidence was inadmissible against Friedland and excluded it. In my view, these facts should have been made clear, particularly as, when one looks to the reasons of Justice Spencer, it is apparent that he paid heed to the plea bargain in particular as evidence against Friedland.

79 The suggestion in the material of the United States is that Mr. Friedland had personal knowledge of the potential environmental problems and liabilities that could result from going forward with the Summitville project before they occurred but then went ahead in a careless manner without regard to the environment.

80 If I am incorrect in taking the inference from the material, so too was Justice Spencer because Justice Spencer, as I have noted, clearly found that. The reasons of Justice Spencer were put before Justice Borins without reservation. In my view, the allegation contained in paragraph 37(4) in this regard is grossly over-stated. It is clear that Mr. Friedland did know that heap leach mining did pose certain risks — this is apparent from the Securities documents that were filed — but there is nothing in the evidence to suggest that he carelessly went ahead with operations or participated in decisions to that effect, as suggested by the reasons of Justice Spencer.

81 The Plaintiff relies on the fact that he attended on behalf of the company before the Colorado Mined Land Reclamation Division, and on that occasion expressed a concern regarding environmental problems and undertook, on behalf of the company, to have them resolved. In my view, that is evidence that he did participate in dealing with a problem after it occurred but it does not support what is the clear insinuation of the Mangone affidavit that he knew of these problems before they occurred and went ahead anyway in a careless manner.

82 A vital allegation against Friedland is that of paragraph 37(5) "that he had a primary role in decision-making for the design and installation of the leach pad liner". It is vital because of the importance attached by the United States to the design and installation of the leach pad liner in its case. In that paragraph, Ms Mangone cites some 39 documents in support of that contention. She was subjected to an extensive cross-examination and was unable to show that any of those documents supported the specific proposition she advanced.

83 The proposition was argued again at some considerable length before me and I have concluded that there is simply nothing in evidence to justify a statement of that kind. The Plaintiff's theory is put in its written factum as follows:

84 It is the Plaintiff's case that the statement of fact advanced by Mangone that Friedland had a primary role in decision-making with respect to the design and installation of the leach pad liner is made out by the following:

85 That Friedland was at the top of the corporate structure, with authority over others involved in the company and that those people collectively made a decision to proceed with winter construction, notwithstanding the risks.

86 That Friedland arranged financing for the project which required gold production in 1986 which, in turn, required winter construction.

87 That Friedland and other SCMCI personnel insisted to Klohn Leonoff and others that winter construction must proceed. (I note here that that is a highly contentious and disputed proposition which is not, in my view, borne out by the facts.)

88 That Friedland visited the site, called on-site personnel for updates, received progress and environmental reports, and attended the MLRB meeting that I have just referred to.

89 In my view, one need only state that theory to show that there plainly is no evidence of the specific and crucial assertion that Friedland had a primary role in decision-making for the design and installation of the leach pad liner. To state the Plaintiff's theory is to expose the fact that the evidence simply does not support a statement of that specificity. Given the significance of the Mangone affidavit and the case that the United States attaches to the problems with the leach pad liner, this is a central and critical allegation against Robert Friedland and, in my view, constituted a material misstatement of the facts.

90 Moreover, there is evidence to the contrary on this point that was not revealed by the Plaintiff and by Ms Mangone. In an investigative memo prepared by Mr. Broste in March of 1995, he notes that Roger Leonard, who was the general manager at Summitville from 1984 to 1986 or 1987, claimed that he took orders from Ed Roper and that he was fired by Roper. Broste says that Leonard says that Roper instructed him to proceed with the winter installation of the leach pad lining in spite of very adverse conditions. Leonard did not know if Friedland was involved in that decision. He reported to Roper and did not know to what extent Friedland was directing Roper but Leonard described Friedland as a financier who did not understand mining.

91 In Roper's response to a demand issued by the EPA pursuant to section 104(e) of the Statute, a procedure by which parties potentially responsible may be compelled to provide answers to questions, a document to which I will return later, Mr. Roper states as follows:

> KL (which is Klohn Leonoff, the engineer) performed or subcontracted all engineering, design, geotechnical, construction, supervision permitting (anything and everything) related to the leach pad. No part of the leach pad was constructed or put into use without KL's written approval of it having passed all engineering and construction requirements. KL was also responsible for the slope stability, engineering work for the open pit design. KL was also responsible for Summitville's water balance engineering requirements. KL was working for GRI and/or SCMCI when I left the employment of the companies. KL had total professional engineering independence.

92 Ms Mangone, on cross-examination, accepted that statement as being truthful. On that basis, I have no hesitation in agreeing with the submission of the Defendant that a possible reading of Mr. Roper's 104(e) response is that in fact it exonerates Mr. Friedland from involvement in the design and construction of the leach pad liner and it indicates the degree of reliance placed by SCMCI on experts such as Klohn Leonoff and other engineers to make these crucial decisions.

93 In addition to those misstatements, there is, in my view, a failure on the part of Mangone to disclose certain contrary evidence in her possession regarding the nature of Mr. Friedland's involvement at Summitville. Again, this emerges from the privileged documents which have been produced. As late as March 1985, it is clear from these documents that the investigators of the EPA had some difficulty in establishing a case against Mr. Friedland. In his memo of March 29th, 1995, Mr. Broste states that, after reviewing a large quantity of documents:

> ...I think it is clear that Friedland had virtually no direct involvement in the day to day operations of Summitville.

94 Ms Mangone, in a memo written a few days later, stated:

> ...Dave Broste and I are at a loss to figure out what else we can be doing now to develop the liability case against Friedland.

95 Now, it is clear that following those memos, a number of further documents were obtained. Those documents include a transcript of Roper's examination for discovery in the KL litigation, Roper's section 104(e) response, certain engineering notes from KL, the plea agreement that I've referred to, and the internal Galactic documents. These documents essentially show that on some occasions Mr. Friedland was present or is listed as being present when discussions of site operations, including environmental questions, were discussed. But they go no further than that.

96 In her referral document, Ms Mangone set out, in a detailed manner, certain contrary evidence that was not disclosed to this Court. She states:

> It should be noted that the evidence shows that Friedland did not have a high profile role in decision-making for the day-to-day operations at the facility.

97 She then goes on to relate that information:

> Steven Enders was chief geologist for SCMCI starting in 1984. His role expanded to include exploration manager for GRL. ... Enders said that mine operation decisions were made by the mine manager and "ultimate mine operation decisions" were made in Vancouver by Ed Roper, Robert Cook and Victor Hollister. Enders knew that Friedland was Roper's boss but

did not know what his involvement was in decisions. Enders said that Friedland visited the mine periodically in connection with promotional activities.

Pritchard Crowell was the controller for the Summitville Mine from 1984 to 1987. In 1987, he transferred to the GRL offices in Vancouver and worked there as assistant secretary and accountant until 1991. Crowell recalled that Friedland met with the mine's engineers, but did not seem to be involved in daily operations. He said that Ed Roper managed the company.

Daniel Blakeman was process superintendent at the Summitville Mine from 1984 to 1987. Blakeman said that he saw Friedland once or twice a year and said that Friedland was unaware of day-to-day mining operations.

Milton Hood was mine superintendent from August to December 1985. He said Friedland visited the mine about once a month to show the mine to his investors. Hood said Friedland never directed mine operations. Hood said that Ed Roper visited the mine about twice a month and that Roper did direct operations at the mine.

Roger Leonard was hired to be the plant manager at Summitville in 1984 and was promoted to general manager shortly thereafter. He was employed at the mine until Ed Roper fired him in 1987. Leonard reported to Roper and did not know to what extent Friedland was directing Roper. Leonard described Friedland as a financier who did not understand mining.

Mark Coolbaugh was hired to work as a geologist at the mine in June, 1984 and continued to work at Summitville until February, 1991. he was the general manager during his last month at Summitville. He said that the mine's general manager made operational decisions at the mine. Coolbaugh never saw Friedland direct operations at the mine and said that Friedland did not have technical expertise.

Jim Burchett was employed at the mine as senior mine engineer in July 1988 and worked there until SCMCI went bankrupt in 1992. He has continued to work at the mine for one of the contractors performing response actions at the site. He was only aware of Friedland being at the site one time during his employment there. He was not aware of Friedland directing operations at the mine.

98 Now, the United States submits that, in view of the theory of liability it advances, facts relating to day-to-day management and control are not relevant. The United States submits that *CERCLA* is very broad and that it will be enough for it to show Friedland's decisions at a more general level; specifically, that his decisions regarding the financing and the effect that decision had on winter construction will be sufficient.

99 I find the excuse offered for not revealing this material to the Court to be wholly unpersuasive, for several reasons.

100 First of all, if that is the theory the U.S.A is relying on, it should have put that theory squarely before Justice Spencer, Justice Borins and Judge Nottingham in the United States. It is clear from the Mangone affidavit and the factum that that is plainly not what those Judges were told. The Plaintiff is now in effect shifting the theory of its case. In my view, the Plaintiff cannot have it both ways.

101 Secondly, the relevance of this information is, in my view, directly contradicted by the fact that Mangone deemed the evidence to be relevant when she was offering her candid opinion to the Department of Justice. One can readily see why she would have formed that conclusion. She had advised the Department of Justice that the Court in Colorado might well apply a strict test requiring active participation in the wrongful act. She had told the Department of Justice that, on the cases, the test for determining liability of an operator was a fact-specific inquiry. One of the criteria listed in that fact-specific inquiry was the role in decision-making and daily management.

102 In my view, on the legal test, as described by Mangone in the Referral Document, the evidence that was not disclosed, described as contrary evidence, clearly was relevant to the decision the Department of Justice would have to make and also was relevant to the decision this Court was asked to make. In my view, Ms Mangone was obliged to set out the facts for and against and she did not do so. Her failure to disclose contrary evidence, I find constitutes a failure to disclose material facts.

103 I note here that the United States also advances the proposition that it made adequate disclosure of Mr. Friedland's position by attaching press releases and newspaper interviews he gave in relation to the problems at Summitville. In my view, that disclosure does not mitigate the non-disclosure and misrepresentations of fact that I have just described. Those articles and releases amount to a far from complete account of Mr. Friedland's position and the very fact that that method was used to disclose his position suggests to the judge hearing the *ex parte* application that the EPA had nothing in its files that would sustain that position.

104 I note as well that in those articles Mr. Friedland questions the propriety of the actions of the EPA and that there is another internal memorandum disclosed as a result of the privilege order in which Mr. Muller, Mangone's predecessor on the file, expressed a very strong view that the EPA, in proceeding in the way it was proceeding, by way of interim action rather than final remedial action, was jeopardizing the claim that it would seek to advance against responsible parties. He stated specifically:

> It is my opinion that proceeding with the FFS's interim actions instead of as final remedial actions will be inconsistent with *CERCLA* and the NCP and will seriously jeopardize our cost recovery case.

105 That, too, was not disclosed to the *ex parte* judge.

Quantum of the claim and availability of other remedies.

106 In paragraphs 35 and 36 of Mangone's affidavit, she deposes that the EPA's response costs to date are $95,750,872 and, relying on an affidavit from another official, she states that the total of the expended and currently planned response costs was estimated to be $152.5 million. What Ms Mangone did not disclose was certain inconsistencies and figures offered within the Referral Document.

107 In the Referral Document, sent, as I have noted, days before she swore this affidavit, the response costs are estimated to be $120-140 million. In a notice filed in the public Federal Register on August 7, 1996, in an attempt to justify certain settlements that were proposed with so-called *de minimis* PRPs, a notice authored by Mangone, the costs were stated to be estimated at $120 million, some $32 million less than this Court was told.

108 Further, Mangone did not disclose to the Court that certain settlements were underway, in particular the *de minimis* settlement that I have just mentioned which would produce $700,000. She did not disclose that other settlements were possible which, at one point at least, she estimated might bring as much as $10 million.

109 She further failed to disclose that the State of Colorado was legally obliged to contribute ten per cent of the costs — on her figures, this would be $15 million — and it is clear that the United States' claim would be reduced by that amount.

110 In defence, it is submitted by the United States that the U.S.A. and the State of Colorado are both Plaintiffs in the District Court action and hence the total of $152 million could still be recovered against the Defendant Friedland. It is submitted that this is merely a technical point and that the U.S.A. should be entitled to an injunction for the whole amount.

111 In my view, this is far from a technical point and the facts should have been disclosed to the Court. It is surely relevant to the exercise of this Court's discretion that a significant part of the assets to be frozen, in this case some U.S.$15 million, were in fact to be recovered by another party not before the Court. It is by no means clear to me that, apprised of that fact, a Judge would have granted an injunction for the full $152 million.

112 All of these facts relevant to the quantum of the claim, in my view, should have been disclosed. They represent a discrepancy of up to as much as $50 million.

113 It may be that the United States could offer an answer as to why the injunction should still be granted for that amount but it was obliged to give that answer to the Judge; it was not entitled to deprive the *ex parte* Judge of information that was, in my view, plainly relevant to the exercise of the discretion.

114 Another related area bearing on the right of the United States to an injunctive relief relates to the other potentially responsible parties (PRPs). The privileged documents reveal that since 1993 the United States has had in mind pursuing a long list of PRPs, including three other significant institutional parties of substantial means who were involved in the construction and operation of the mine. Those parties are:

115 The Bank of America which financed the project. The theory apparently to be advanced against the Bank is similar to that advanced against Friedland, namely that the Bank pressured SCMCI and GRL to construct the heap leach pad within a specified time frame, requiring winter construction so as to get early production. It is also alleged against the Bank that it had an active day-to-day management and operation role, given the terms of its lending agreement.

116 A second party potentially responsible is International Constructors Corporation. This was an independent contractor which operated the mine for several years and was involved directly in mining and transporting material at the mine.

117 Thirdly is Bechtel Civil & Minerals Inc., the engineering firm responsible for overseeing construction of the mine.

118 On October 3rd, 1995, Ms Mangone was asked to provide answers to certain questions regarding her Region's enforcement strategy. In this letter, which was produced as a result of the privilege order, she states as follows:

> The Region does have an enforcement cost recovery strategy for pursuing PRPs for the Summitville site. While we are currently developing evidence on a number of fronts, the basic approach is to file a *CERCLA* section 107 cost recovery action against all Tier I PRPs jointly and severally.

119 There is nothing in the evidence before me to suggest the EPA has abandoned that strategy.

120 In the same memorandum, Mangone describes briefly the case against these parties, and she states as follows:

> A number of these parties, such as Robert Friedland, Bank of America, Bechtel and ICC are sufficiently capitalized to pay the bulk, if not all, of the United States' response costs for the site. While there may be some litigative risks associated with recovering response costs from Friedland and Bank of America, we should have a strong case against ICC and Bechtel.

121 All of these parties are also listed as potentially responsible parties in the Referral Document.

122 The justification for non-disclosure of this information offered by the United States is, first of all, that it was referred to in the affidavit filed in the U.S. proceedings, where Mangone indicated that boxes of material had been collected, with reference to these PRPs. In my view, that was totally insufficient by way of disclosure.

123 It is further argued that the case against these PRPs has not been fully developed and that, in any event, it is not a defence to Mr. Friedland to show that other parties might be responsible. In my view, neither these contentions justify the failure to disclose the possibility of pursuing these other parties.

124 I find that the facts relating to the possibility of pursuing other parties, parties of substance, was clearly relevant to the exercise of the Court's discretion to grant a *Mareva* injunction. One gains the distinct impression from the material filed by the Plaintiff that Robert Friedland is the culprit and that if there is no recovery from Robert Friedland, there is a significant risk that environmental costs will fall to be borne by the taxpayers of the United States.

125 The fact that the United States sees Mr. Friedland as its main target does not obscure the fact that he is not the only target and indeed, as Mangone in her letter of October 1995 stated, she thought that while there were certain risks of proceeding against him, there was a strong case against certain other parties.

126 As I have already noted, the *Mareva* injunction is an exceptional and extraordinary remedy which is available to plaintiffs whose rights will be defeated if something is not done on an urgent basis.

127 Even assuming the Plaintiff were able to show a strong *prima facie* case against Mr. Friedland, it is my view that in assessing and in balancing the burden the injunction would impose on Mr. Friedland, with the risk that the Plaintiff's lawful claims might be defeated, the Court was entitled to know about the other possible available avenues of recourse available to the Plaintiff. It is possible that apprised of all of these facts relating to the other parties, the Court might still have granted the injunction but it is by no means, in my view, self-evident, given the exceptional nature of *Mareva* relief.

128 In any event, that was a decision for the Court not for the United States of America, and the material presented by the United States of America deprived the Court of the opportunity to make that assessment.

"Flight Risk".

129 The Notice of Motion filed before this Court stated, as grounds for the *Mareva* injunction, the following:

> There is a real and substantial risk that the Defendant, a resident of Singapore and/or Australia, if given notice of this motion, will remove or dispose of the securities, which are the Defendant's only known assets in the United States or Canada, from the jurisdiction before a judgment of the District Court or the B.C.S.C., which would be enforceable in this Court, can be rendered or satisfied, thereby causing Plaintiff irreparable harm.

130 The Mangone affidavit deposes to certain facts relevant to this point, namely that certain attempts to serve Friedland under *CERCLA* with 104 (e) requests were met with rebuff. She deposes that Friedland has disposed of certain real property he owned in the United States. She indicates his move from Vancouver to Singapore and Sydney. And she relates that he has asserted privilege claims in relation to documents the EPA wishes to obtain which are held by the solicitors for Galactic.

131 In the factum filed in support of the *ex parte* order, this evidence is summarized in the following fashion:

> ...based upon Friedland's *modus operandi* in relation to other assets, such as the California and Colorado real estate properties, there is a risk that Friedland could transfer the shares into the possession of, or register them in the name of, other persons. Furthermore, based on his avoidance of service of information requests made by EPA, the misstatements as to his address in *Insider Report* filings, and other factors in his background ... there is ample reason to conclude that Friedland can and may well take steps to avoid the jurisdiction of this court, thereby rendering any judgement of this court nugatory.

132 The factum concludes with a citation to a case which is put in the following manner. The citation is to the decision of *Mooney v. Orr*, which I have already referred to, and the following quotation is included:

> The English Court of Appeal devised the *Mareva* injunction for marauding charterers. It is equally well-suited to marauding deal-makers to ensure that those B.C. residents who structure their business and personal lives to preserve assets out of sight and attack, may be enjoined from dealing with those assets except under the court's supervision during litigation.

133 The factum concludes with the statement:

> This case, it is submitted, falls squarely within this principle.

134 Justice Spencer was clearly persuaded by this. In his reasons, he states:

> There is a real risk that the defendant may remove assets from this jurisdiction to defeat any judgment against him.

135 He states further, after reviewing the evidence in the Mangone affidavit:

> All of that shows a desire to pick and choose places of residence and to avoid jurisdictions where he might be exposed to claims against him. All of that suggests a real risk that he will remove assets from any jurisdiction where a judgment may be had or enforced including this jurisdiction.

136 It is significant, in my view, that the United States of America more or less abandoned this allegation, by implication, in that it argued strenuously that nefarious, fraudulent or deliberate intent to defeat the process of the court was not required, as a matter of law, to justify a *Mareva* injunction and that it was enough to show that the effect of Mr. Friedland's actions would be to put his assets out of reach.

137 On cross-examination, Ms Mangone admitted that she had nothing to show that the real estate transfers were other than *bona fide*.

138 The characterization of Mr. Friedland's resistance to the 104(e) demands as evasion was, in my view, completely unwarranted. The position he took, or his counsel took, which so far as I can tell has not been refuted or at least not shown to be without *bona fides*, were that these demands were unlawful and that he did not, in law, have to respond.

139 The most serious non-disclosure and misrepresentation, in my view, of Mr. Friedland's position as an alleged "flight risk" arises with respect to a possible settlement of the claim. This comes again from the affidavit of Ms Mangone. Ms Mangone states in her affidavit, as follows:

> Although I have not personally spoken with Friedland, his local counsel, Mr. John D. Fognani of the Denver firm, Gibson, Dunn & Crutcher, has told me that both he and Friedland believe that Friedland is not liable under *CERCLA* for the conditions at the site.

140 This statement was based upon a meeting between Ms Mangone and Mr. Fognani, the details of which are not explained in the affidavit. However, again as a result of the privilege order, a draft letter that Ms Mangone authored to Mr. Fognani was produced. Although the letter was apparently not sent, Ms Mangone did not dispute that it set out accurately what had been discussed at the meeting from which Ms Mangone asserted the Friedland was denying liability. She states in this draft letter, as follows:

> As I understand your proposal, your client, Mr. Robert M. Friedland, is now interested in settling any potential civil and criminal liabilities he may have for the Summitville Mine Superfund Site. He also wishes to include other potentially responsible parties in his settlement proposal, although those parties are yet to be defined. The basic tenets of the proposal are that Mr. Friedland and/or this PRP group undertake "reasonable" response actions to complete the cleanup of the site, as well as providing a "substantial" or "significant" cash contribution to extinguish civil liability for past response costs.

141 The draft letter goes on to explore certain information that the EPA would require.

142 It has been acknowledged, and I refer here again to the English text *Gee* at page 103, that where the plaintiff has been engaged in open negotiations with the defendant, that that is a matter relevant to the exercise of the court's discretion as it bears upon whether the plaintiff needs urgent *ex parte* relief. Mr. Gee states, as follows:

> If the defendant is willing to attend an open meeting to discuss the claim, this may indicate a measure of responsibility in relation to his legal obligations which would cast doubt on whether the case was suitable for *Mareva* relief.

143 I find the excuse offered for not disclosing this or for, more importantly, misdescribing it by Ms Mangone, unpersuasive. It is submitted that this was a privileged discussion and that it would be contrary to EPA policy for her to discuss it in any way.

144 It is difficult for me to imagine how that justification could, in any way, permit Ms Mangone to use the part of the discussion that suited her purposes, namely, that Friedland maintained that he was not legally responsible for these costs, while omitting the part that didn't suit her purposes.

145 I note, moreover, that these discussions were in one sense open discussions, in that they arose as a result of a newspaper article in which Mr. Friedland had indicated a willingness to discuss the situation with the EPA and, moreover, that there is some evidence that, following the discussion, Ms Mangone did tell a reporter that she had had this discussion but that confidentiality precluded her from giving the details.

146 The *ex parte* judge, in my view, could have been told that while Mr. Friedland was unwilling to admit legal liability, there had been some preliminary discussion indicating his willingness to resolve the problem himself and in cooperation with other parties. In my view, it was a serious distortion to characterize this exchange as simply a denial of liability, suggesting that Mr. Friedland was totally unwilling to cooperate in any way with the EPA in resolving the problems that had arisen.

147 The insinuation of the United States that Mr. Friedland has arranged his affairs to avoid his legal obligations is, in my view, totally unsupported by the evidence. The record does indicate that he is fully prepared to assert his legal rights to the demands of the EPA and that he has advanced claims of privilege in relation to material sought by the EPA. However, there is no suggestion that this assertion of rights or claims is unwarranted in the sense of being spurious or lacking in good faith.

148 Mr. Friedland's wide range of business activity has meant that he travels extensively and that the focus of his business interests now lies in Asia. He has moved from North America. As might be expected of a successful international entrepreneur, he moves his assets according to the opportunities and ventures that attract him. In all of this, however, there is simply no evidence before me, nor was there any evidence, in my view, available to the United States, to suggest that he has disposed of property, moved or dealt with assets so as to avoid or evade his creditors. The United States presented that as a fact to the *ex parte* judge and I find that that was a material misrepresentation of the facts.

Use and description of the proceedings before Judge Nottingham under the Federal Debt Collection Procedure Act.

149 The statutory procedure under the *Federal Debt Collection Procedure Act* permitted the U.S.A to obtain a garnishment order. In Mangone's affidavit, that order was described as a temporary restraining order. In the factum filed on the *ex parte* application, it is described as follows:

> A temporary restraining order (TRO) in the District Court preventing Friedland from dealing with U.S.$152 million (the total reasonably projected cost of dealing with the cleanup) pending disposition of the Complaint.

150 At a later point in the factum, it is, I must note, referred to as a "garnishment order".

151 It is clear from the transcript of the hearing before Judge Nottingham, which was produced after the *ex parte* order was granted, and clear from the cross-examination of Ms Mangone, that the United States knew at the time it brought the motion before Judge Nottingham that Mr. Friedland had no assets that could be the subject of a garnishment order. The purpose of the motion, it is apparent, was to show the Canadian courts that relief similar to that being sought from those courts had been sought and obtained in the United States and that the principle of comity might extend to persuade the Canadian court to grant similar relief.

152 It is clear from the reasons of Judge Spencer that he was impressed by the fact that Judge Nottingham had given the order that he gave. The order was not a temporary restraining order and this was a misdescription of that order. It is submitted that this was not significant or merely inadvertent. Again, I find this unpersuasive. The major purpose of going to Judge Nottingham was, as I have just said, to show an Ontario Court that the Plaintiff had sought and obtained similar relief in the United States Court. The Ontario Court was being asked to respect the principle of comity. In my view, in those circumstances, it was not asking too much to insist that the Plaintiff provide a fair and accurate description of the precise nature of the remedy it sought and obtained from Judge Nottingham.

153 When one turns to the brief that was filed in the United States Court before Judge Nottingham, one finds similar allegations of direct involvement by Mr. Friedland and allegations that he is a "flight risk". It is stated the Friedland controlled mining operations at Summitville; that he exercised pervasive control over the actions of these corporations with respect to the site; that he exercised extreme control over the operations at the site. It is further stated:

> It is clear that Defendant Friedland's direct authority and control over the mine site, and his direct authority and control over the activities at the mine site leading to the release of hazardous substances, makes him a liable operator under *CERCLA*. ...
>
> Defendant was intimately involved in all major decisions associated with the mining operations at the Summitville site...

154 It is further stated significant decisions related to design and construction of the site were his.

155 And it concludes:

> As a result of the formal positions he held, his close involvement with major decisions affecting the mining operations, and as well as a result of his extensive influence within these corporations, Mr. Friedland had the actual authority to control and in fact did control the operations at the Summitville mine.

156 Ms Mangone's affidavit deposes that she was fortified in her conclusion of the strong *prima facie* case by virtue of the findings of Judge Nottingham and, as I have noted, this impressed Judge Spencer in British Columbia and Judge Borins in this Court.

157 The transcript of the proceedings before Judge Nottingham make it clear, first, that Ms Mangone was present and, secondly, that there was virtually no consideration of any kind of the merits of the case. Judge Nottingham was concerned by procedural issues: When the order would be served on Mr. Friedland? Should the file be sealed? He also posed questions regarding the jurisdiction of the case and was told by counsel for the United States, as follows:

> The heart of the case is that he is very very very much involved with the site of Colorado and the Summitville mining operations at least.

158 Judge Nottingham's response to that was, as follows:

> Well, I guess he can appear and contest jurisdiction if the asserted basis for jurisdiction is incorrect.

159 It is clear that the order given by Judge Nottingham was made on the basis of similar or perhaps even more exaggerated representations than those made to the British Columbia and Ontario Courts and that it is entitled to little or no weight. Judge Nottingham does not appear to have given any consideration to the merits or strength of the United States' case, perhaps because of the statutory regime under which he was operating, and yet the impression was given to the Canadian Courts that a United States Court had given its considered opinion on this matter.

Facts relating to the need for proceeding ex parte.

160 As I have indicated, the motion originally brought in May was adjourned when it was learned by the United States that the Diamond Fields/INCO transaction had been postponed. What was not disclosed at any time was that the INCO securities filing made it clear that Mr. Friedland was irrevocably committed to the Diamond Fields/INCO transaction. It is my view that that clearly might have had an important bearing on whether a court would permit this matter to proceed *ex parte*. The justification for proceeding *ex parte* is urgency. Here, almost three months expired from the time the matter was originally brought in May.

161 The other justification for an *ex parte* order is that there is a risk that, if given notice, the Defendant might remove assets or dispose of assets so as to defeat the rights of the Plaintiff.

162 The simple fact is that Mr. Friedland was legally bound to complete the transaction and that that, accordingly, had a direct bearing on whether an *ex parte* proceeding was justified.

163 There were three months between May, when the application was first brought, and August, and Mr. Friedland could have been served during that time. In my view, this was plainly a matter that should have been raised before Justice Borins.

164 The United States submits that notice of these proceedings might have affected the INCO transaction and the interests of third parties. It is difficult to understand this submission because the injunction had nothing to do with INCO but, rather, was to enjoin Mr. Friedland after the transaction had been completed and could take no priority over any right INCO or any third party might have had.

165 In any event, even if there was such a risk, it is my view that that was a matter for the Court to assess in determining whether this matter should proceed *ex parte* or not. By not disclosing this important term of the INCO agreement, the United States of America deprived this Court of the opportunity to make that assessment.

166 I note here that, with respect to this and certain other points regarding non-disclosure, the fact that the INCO circular was before the Court and that it might have been argued, although, in fairness, the United States did not make this argument, that the information had therefore been disclosed.

167 In my view, the fact that a document is before the Court, given the volume of exhibits and the time which an *ex parte* judge has to deal with such matters, does not relieve the moving party of its duty to make full and fair disclosure. It is apparent that a judge cannot read all of that material and that the judge will necessarily focus on the lead affidavit, the factum and the representations of counsel, and that it is up to the parties and counsel to bring relevant matters to the attention of the Court.

168 I refer for that proposition to the *Gee* text at page 99 and 100.

169 For these reasons, I have no hesitation in finding that the United States of America failed to make full and frank disclosure of the case of Justice Borins when it sought an *ex parte Mareva* injunction.

170 In my view, the material submitted contained material statements of fact which are misleading; statements of fact which are wholly unsupported by evidence; that there was a failure to disclose material facts in relation to the liability of the Defendant; that there was a failure to disclose material facts relevant to the exercise of this Court in its discretion to grant a *Mareva* injunction.

171 In my view, this is not imposing upon the Plaintiff an unrealistically high standard of disclosure. The United States of America has been preparing its case against Mr. Friedland for a number of years. It had, even if it was rushing to file material in May, another three months before the matter was returned to the Court.

172 Moreover, Ms Mangone had at hand readily a full and detailed analysis of the case, her Referral Document.

173 This is not a situation where there are just one or two instances but, rather, a pervasive failure to live up to the duty in all areas of the case.

174 I have concluded that the United States of America made no serious effort or attempt to take an objective view of its case and present it in a frank, fair and balanced way to the *ex parte* judge.

175 What are the consequences of this failure? I am referred to two decisions of the English Court of Appeal, *Brink's Mat Ltd. v. Elcombe*, [1988] 1 W.L.R. 1350, and *Lloyd's Bowmaker v. Britannia Arrow Holdings*, [1988] 1 W.L.R. 1337, where the English Court of Appeal has held that despite non-disclosure or failure to live up to this duty, there is a discretion to continue an injunction.

176 In my view, the authorities applicable in Ontario establish that these cases do not state the law in this jurisdiction. Those authorities establish that where there has been a finding of material non-disclosure or misstatement, the injunction must be set aside as a matter of right, without regard to whether the injunction might be sustainable on the basis of a corrected record, and that a litigant who fails to make full and frank disclosure forfeits whatever right it might have had to a *Mareva* injunction.

177 I refer here to the passage I have already quoted from the judgment of Associate Chief Justice Mackinnon in *Chitel v. Rothbart*; and to the following Ontario authorities: *BBM Bureau of Measurement v. Cybernauts Ltd.*, [1992] 8 C.P.C. (3d) 294 at 301, where Justice Davidson expressly declines to follow the *Brinks v. Mat* case; *Lynian Ltd. v. Dubois*, [1990] 45 C.P.C. (2d) 231; and *Bardeau Ltd v. Crown Food Services Equipment Ltd.*, [1982] 38 OR (2d) 411 at 413.

178 Moreover, even if I were of the view that there did exist a residual discretion to continue the injunction, I would not exercise that discretion in this case. In my view, the extent of non-disclosure and misstatement by the United States of America

was serious and fundamental. It represents conduct which deserves to be sanctioned by this Court and, in my view, a party guilty of such conduct has abandoned any claim to have the equitable discretion of this Court exercised in its favour.

179 In view of the conclusion I have reached regarding the United States of America's failure to make full and frank disclosure, it is not strictly necessary for me to consider the three other issues that have been raised. While I do not think it appropriate in these circumstances to deal with the legal issues concerning the jurisdiction of this Court to make the order, or the need to show intention to evade the process of the Court, I do propose briefly to deal with the other issue.

Has the Plaintiff established a strong prima facie case?

180 It is agreed by all parties that that is the appropriate standard required of a party who seeks a *Mareva* injunction. In my view, there are serious shortcomings in the case of the United States of America on this standard.

181 First of all, there is the question of admissibility of evidence. During the hearing, as I have indicated, I excluded certain evidence, namely, the plea bargain and extracts from discovery of Mr. Roper in another action, and notes of counsel preparing for that discovery. I reserved on the question of whether the Mangone affidavit, or substantial portions thereof, should be struck out. Rule 39.01(4) does permit hearsay evidence on motions of this kind. It provides:

> An affidavit for use on a motion may contain a statement of a deponent's information and belief if the source of the information and the fact of the belief are specified in the affidavit.

182 While I would not apply this rule in a formalistic manner, and while I recognize that to some extent perhaps practice has become relatively lax in this area, even by those lax standards it is clear that the Mangone affidavit exceeds anything approaching what is acceptable. The documents attached to the affidavit are plainly hearsay. The references given in the tabs are so general that it is difficult, if not impossible, to identify what document is relied upon for a specific statement.

183 Indeed, as I have noted, on significant matters Ms Mangone herself was unable to do this on cross-examination. Accordingly, had it been strictly necessary to do so, I would have had no hesitation in striking out substantial portions of her affidavit and, in particular, paragraph 37 which contains the key allegations against Mr. Friedland.

184 I note as well that there are other serious deficiencies in the Plaintiff's evidence against Mr. Friedland. The Plaintiff's case is essentially that Mr. Friedland's role as a key decision-maker in arranging financing, negotiating engineering contracts, and hurrying the project through winter construction, had a dire environmental impact.

185 A careful review of the documents and, in particular, the Referral Document, indicates that this contention, while possible, is anything but clear. There is a very revealing statement in the Referral Document where Ms Mangone states, after reviewing the relationship between various individuals and their participation or what the EPA knew of their participation in decisions:

> Given this loose chain of command, Ed Roper may be the only person in a position to know the extent of Friedland's involvement in decision-making in the liner issue and on-site construction and operational matters as a whole. In depositions taking for the KL lawsuit, Roper implicated Friedland as having shared the decision-making responsibility over bringing the project into production, stating that he and Friedland made all decisions together.

186 It is telling, in my view, that the Plaintiff United States has offered no affidavit from Ed Roper nor did it summons Mr. Roper as a witness. Counsel indicated the Mr. Roper was unwilling to come forward for various reasons, including, apparently, his own fear of personal liability and a falling out he had had with Mr. Friedland.

187 In my view, based on what I have, it is by no means clear precisely what Mr. Roper would say. We know what the United States hopes he will say but it is not clear what in fact he will say. As I have already noted, his 104(e) response does not unambiguously favour the case of the United States.

188 Other so-called evidence relied upon by the United States to show that his authority was undermined was a lawyer's letter written in relation to a constructive dismissal action, stating that in 1987 Mr. Roper's authority had been undercut. What

was not referred to was the fact that in the same letter, the lawyer asserted that for the crucial period for the purposes of this lawsuit, 1984 to 1987, Mr. Roper had plenary authority and control of president of the company.

189 The absence of any direct evidence from Mr. Roper is, as I have said, telling. But we are not dealing with a case with a total vacuum of evidence because, of course, we have the affidavit of Robert Friedland. I am going to quote a significant paragraph in his affidavit as it sets out his position in a clear way:

> To state the matter simply, during the material period I was the chief executive officer, not the chief operating officer, for Galactic Resources Ltd. I am not a geologist or an engineer. I am a financier and venture capitalist. In planning the Summitville Mine, GRI hired Ed Roper, whom we believed was one of the best mining persons available and at the time was by reputation one of the leading experts in the emerging field of heap leach mining technology, that is, the extraction of precious metals from ore by heap leach mining technology using cyanide. Second, GRL retained one of the largest and most respected civil engineering firms in the world, Bechtel Civil & Minerals Ltd, to design the mine and related facilities at the Summitville mine site, all encompassed within an integrated, bankable Feasibility Study of such a stand to support non-recourse project finance. Further project financing was thereafter provided by the Bank of America in reliance upon the Bechtel design. It was a condition of the financing that the Bank of America had to approve the technology and the design of the Summitville mine by its own independent mining consultants. I relied upon the professionals to design the Summitville mine and make operational decisions as any responsible executive would have done.

190 Mr. Friedland in his affidavit goes on to point out that GRL was a publicly held company; that all decisions to proceed with construction, development and operation of the mine were authorized by the board of directors, as a whole, and based upon the recommendation of mining and other professional engineers; that he had no prior knowledge, as suggested by the reasons of Justice Spencer, of the environmental problems. He recites at length the role played by Bechtel and other experts in design of the mine. He deposes, "I maintained no material responsibility for design, construction or day-to-day operation of the mine" and he states, "I was not involved in SCMCI at an operational level and I was not even an officer or director of SCMCI for about 85 per cent of the period between 1986 and 1992". GRL had many other mining ventures beyond Summitville in progress in various parts of the world, and that these other projects occupied a great deal of his time.

191 He deposes that he "was constantly travelling around the world, seeking out new mining venture opportunities, raising substantial financing, and promoting various ventures".

192 He categorically denies that he had "a primary role in decision-making for the design and installation of the leach pad liner".

193 Mr. Friedland was cross-examined for some ten hours on this affidavit, and again I have carefully read that cross-examination. No significant challenge was made to his version of his role and responsibility at the mine. Indeed, having reviewed the documents, it appears to me that his version is in fact closer to what is suggested by the documents than that relied upon by the United States of America.

194 The United States produced, after the *ex parte* order had been given, an affidavit from a junior level engineer with Klohn Leonoff, Tom Krasovec. I note here that there was a dispute between SCMCI relating to Klohn Leonoff which resulted in litigation and which was ultimately settled in SCMCI favour.

195 Mr. Krasovec produced notes that he had made at the time regarding problems with the leach pad liner and which indicate that Mr. Friedland was made aware of some of these problems. Mr. Krasovec goes on to describe a tour that he conducted with Mr. Friedland, allegedly in June or July of 1986. He states that he advised Mr. Friedland of certain problems with repairs to the liner, and he states that he recommended to Mr. Friedland that the remainder of the existing pad be ripped down and reconstructed.

196 It is hardly surprising, in my view, that Mr. Friedland did not immediately accept the advice of this junior engineer, given the structure that was in place for this project.

197 Mr. Krasovec further deposes that in August there was another tour with Mr. Friedland and that Mr. Friedland shared his thoughts about the cost of the production, the need for gold production. He states that Mr. Friedland admitted to an assembled group of project employees that he had made a mistake by promising to build the mine under adverse working conditions.

198 If accepted, this evidence could well be significant in the case against Mr. Friedland. However, I note certain important facts that have to be taken into account.

199 First, it is categorically denied by Mr. Friedland that he made any of these admissions that are alleged by Mr. Krasovec.

200 Secondly, as I have already noted, Mr. Krasovec was a very junior level engineer. It is to me surprising that if the United States of America has such an overwhelming case against Robert Friedland, that he exerted pervasive influence over this project apparently influencing and ordering engineers to do things that shouldn't have been done, that it is only able to produce as a witness, as proof of those facts, a person at this level of the operations.

201 The evidence presented has led me to the conclusion that the liability of Robert Friedland under *CERCLA* is anything but clear. It certainly falls very well short of the standard of a strong *prima facie* case that would be required to support a *Mareva* injunction.

202 Accordingly, even if I had dismissed the various contentions advanced by the Defendant that the United States of America failed to satisfy its obligation of full and frank disclosure, I would have had no hesitation in setting the injunction aside and refusing to continue the injunction on the ground that a strong *prima facie* case of liability was not demonstrated.

203 For those reasons, I have endorsed the record as follows:

204 For oral reasons given today, the *ex parte* order of Borins, J. of August 21, 1996, continued by the orders of August 28, 1996 and September 6, 1996, is set aside and the Plaintiff's motion is dismissed. (Submissions by counsel follow)

205 — LUNCHEON ADJOURNMENT

206 — UPON RESUMING AT 2.40 P.M.

207 HIS HONOUR: I have added the following to my endorsement:

208 In my view, the findings I have made amply warrant an order requiring the Plaintiff to pay the Defendant's costs on a solicitor-and-client basis. While party-and-party costs are the rule, my reasons for judgment make it clear that I consider the Plaintiff to have been guilty of conduct which merits the censure of this Court.

209 The conduct of the Plaintiff was, in my view, a serious departure from a fundamental rule important to the integrity of the judicial process. It falls within the principles recently enunciated by the Manitoba Court of appeal in *Pulse Microsystems Ltd v. SafeSoft Systems Inc.*, [1996] 134 D.L.R. (4th) 701 at 715. I order that those costs be assessed and paid forthwith.

210 I am asked to stay my order until the end of Friday to permit the Plaintiff to consider an appeal and, if so advised, to seek a stay of my order dissolving the injunction from the appropriate appellate court.

211 In view of the findings I have made on non-disclosure and misrepresentation, it is my view that apart from one point the Plaintiff is not entitled to the exercise of the Court's discretion. In my view, the sole point that deserves any consideration is the contention that its rights of appeal could be rendered nugatory if no stay is granted. This has been recognized as a valid basis for granting a stay. (*Van Brugge v. Arthur Fromer International Ltd.* [1982 35 OR (2d) 333; *Erinford Properties Ltd. v. Cheshire Country Council*, [1974] 1 Chancery 261)

212 In my reasons for judgment, I dismissed as unfounded the contention that the Defendant has demonstrated any intent to defeat the process of this Court or any other Court. Obviously, there was nothing before me to cause me to alter my view on that point in any way.

213 The difficulty I face is that that point is the very ground relied upon for granting the stay and a potential ground of appeal, namely, that if the stay is not granted the Defendant may defeat the process of the Court.

214 A litigant in our system does have the right to appeal and to challenge findings that have been made and, as noted, a stay may be granted to protect the right of appeal.

215 In the circumstances, and with some considerable hesitation, I grant a short stay until 4.30 p.m. Friday, November 8th, 1996 on the narrow ground outlined herein, to afford the Plaintiff the opportunity to consider an appeal and present an application for a stay to a judge of the appropriate appellate court.

216 (Submissions by counsel follow)

217 HIS HONOUR: What I've done is I've endorsed a draft copy of your order, as follows,

218 Upon reading my endorsement relating to the stay, Mr. Lenczner made the undertaking that the shares would be held until 4.30 p.m., November 8, 1996, subject to any order, as per this draft order.

219 In my view, it is appropriate to dispose of this matter on the basis of Mr. Lenczner's undertaking, as reflected by this draft order, a copy of which I have signed.

220 THE REGISTRAR: Court is now adjourned.

221 — HEARING ADJOURNED AT 2.50 P.M

Tab 2

1997 CarswellOnt 1489
Supreme Court of Canada

Soulos v. Korkontzilas

1997 CarswellOnt 1489, 1997 CarswellOnt 1490, [1997] 2 S.C.R. 217, [1997] S.C.J. No. 52, 100 O.A.C. 241, 146 D.L.R. (4th) 214, 17 E.T.R. (2d) 89, 212 N.R. 1, 32 O.R. (3d) 716 (headnote only), 46 C.B.R. (3d) 1, 9 R.P.R. (3d) 1

Fotios Korkontzilas, Panagiota Korkontzilas and Olympia Town Real Estate Limited, Appellants v. Nick Soulos, Respondent

La Forest, Sopinka, Gonthier, Cory, McLachlin, Iacobucci and Major JJ.

Heard: February 8, 1997
Judgment: May 22, 1997
Docket: 24949

Proceedings: affirming (1995), 84 O.A.C 390 (Ont. C.A..); reversing (1991), 4 O.R. (3d) 51 (Ont. Gen. Div.); additional reasons at (1991), 4 O.R. (3d) 51 at 71 (Ont. Gen. Div.)

Counsel: *Thomas G. Heintzman, Q.C.*, and *Darryl A. Cruz*, for the appellants.
David T. Stockwood, Q.C., and *Susan E. Caskey*, for the respondent.

Subject: Insolvency; Estates and Trusts; Contracts; Torts

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Reading v. R., [1948] 2 K.B. 268, [1948] 2 All E.R. 27 (Eng. K.B.) — considered

Reading v. R., [1949] 2 K.B. 232, [1949] 2 All E.R. 68 (Eng. C.A.) — considered

Reading v. R., [1951] A.C. 507, [1951] 1 All E.R. 617 (Eng. H.L.) — considered

Syncrude Canada Ltd. v. Hunter Engineering Co., (sub nom. *Hunter Engineering Co. v. Syncrude Can. Ltd.)* [1989] 3 W.W.R. 385, (sub nom. *Hunter Engineering Co. v. Syncrude Can. Ltd.)* 57 D.L.R. (4th) 321, (sub nom. *Hunter Engineering Co. v. Syncrude Can. Ltd.)* 35 B.C.L.R. (2d) 145, (sub nom. *Hunter Engineering Co. v. Syncrude Can. Ltd.)* 92 N.R. 1, (sub nom. *Hunter Engineering Co. v. Syncrude Can. Ltd.)* [1989] 1 S.C.R. 426 (S.C.C.) — considered

APPEAL from judgment reported at [1995] 84 O.A.C. 390, allowing appeal from (1991), 4 O.R. (3d) 51 (Gen. Div.), additional reasons at (1991), 4 O.R. (3d) 51 at 71 (Gen. Div.) which refused to grant remedy of constructive trust for breach of fiduciary duty when no resulting unjust enrichment.

POURVOI à l'encontre d'un arrêt publié à [1995] 84 O.A.C. 390, accueillant le pourvoi à l'encontre de (1991), 4 O.R. (3d) 51 (Gen. Div.), motifs additionnels publié à (1991), 4 O.R. (3d) 51 à 71 (Div. Gén.), refusant le redressement en vertu de la fiducie par interprétation résultant de la violation de l'obligation fiduciaire lorsque aucun enrichissement sans cause n'en résulte.

***McLachlin J.* (La Forest, Gonthier, Cory and Major JJ. concurring):**

I

1 This appeal requires this Court to determine whether a real estate agent who buys for himself property for which he has been negotiating on behalf of a client, may be required to return the property to his client despite the fact that the client can show no loss. This raises the legal issue of whether a constructive trust over property may be imposed in the absence of enrichment of the defendant and corresponding deprivation of the plaintiff. In my view, this question should be answered in the affirmative.

II

2 The appellant Mr. Korkontzilas is a real estate broker. The respondent, Mr. Soulos, was his client. In 1984, Mr. Korkontzilas found a commercial building which he thought might interest Mr. Soulos. Mr. Soulos was interested in purchasing the building. Mr. Korkontzilas entered into negotiations on behalf of Mr. Soulos. He offered $250,000. The vendor, Dominion Life, rejected the offer and tendered a counter-offer of $275,000. Mr. Soulos rejected the counter-offer but "signed it back" at $260,000 or $265,000. Dominion Life advised Mr. Korkontzilas that it would accept $265,000. Instead of conveying this information to Mr. Soulos as he should have, Mr. Korkontzilas arranged for his wife, Panagiota Goutsoulas, to purchase the property using the name Panagiot Goutsoulas. Panagiot Goutsoulas then transferred the property to Panagiota and Fotios Korkontzilas as joint tenants. Mr. Soulos asked what had happened to the property. Mr. Korkontzilas told him to "forget about it"; the vendor no longer wanted to sell it and he would find him a better property. Mr. Soulos asked Mr. Korkontzilas whether he had had anything to do with the vendor's change of heart. Mr. Korkontzilas said he had not.

3 In 1987 Mr. Soulos learned that Mr. Korkontzilas had purchased the property for himself. He brought an action against Mr. Korkontzilas to have the property conveyed to him, alleging breach of fiduciary duty giving rise to a constructive trust. He asserted that the property held special value to him because its tenant was his banker, and being one's banker's landlord was a source of prestige in the Greek community of which he was a member. However, Mr. Soulos abandoned his claim for damages because the market value of the property had, in fact, decreased from the time of the Korkontzilas purchase.

4 The trial judge found that Mr. Korkontzilas had breached a duty of loyalty to Mr. Soulos, but held that a constructive trust was not an appropriate remedy because Mr. Korkontzilas had purchased the property at market value and hence had not been "enriched": (1991), 4 O.R. (3d) 51, 19 R.P.R. (2d) 205 (Ont. Gen. Div.) (hereinafter cited to O.R.). The decision was

reversed on appeal, Labrosse J.A. dissenting: (1995), 25 O.R. (3d) 257, 126 D.L.R. (4th) 637, 84 O.A.C. 390, 47 R.P.R. (2d) 221 (Ont. C.A.) (hereinafter cited to O.R.).

5 For the reasons that follow, I would dismiss the appeal. In my view, the doctrine of constructive trust applies and requires that Mr. Korkontzilas convey the property he wrongly acquired to Mr. Soulos.

III

6 The first question is what duties Mr. Korkontzilas owed to Mr. Soulos in relation to the property. This question returns us to the findings of the trial judge. The trial judge rejected the submission of Mr. Soulos that an agreement existed requiring Mr. Korkontzilas to present all properties in the Danforth area to him exclusively before other purchasers. He found, however, that Mr. Korkontzilas became the agent for Mr. Soulos when he prepared the offer which Mr. Soulos signed with respect to the property at issue. He further found that this agency relationship extended to reporting the vendor's response to Mr. Soulos. This relationship of agency was not terminated when the vendor made its counter-offer. The trial judge therefore concluded that Mr. Korkontzilas was acting as Mr. Soulos' agent at all material times.

7 The trial judge went on to state that the relationship of agent and principal is fiduciary in nature. He concluded that as agent to Mr. Soulos, Mr. Korkontzilas owed Mr. Soulos a "duty of loyalty". He found that Mr. Korkontzilas breached this duty of loyalty when he failed to refer the vendor's counter-offer to Mr. Soulos.

8 The Court of Appeal did not take issue with these conclusions. The majority did, however, differ from the trial judge on what consequences flowed from Mr. Korkontzilas' breach of the duty of loyalty.

IV

9 This brings us to the main issue on this appeal: what remedy, if any, does the law afford Mr. Soulos for Mr. Korkontzilas' breach of the duty of loyalty in acquiring the property in question for himself rather than passing the vendor's statement of the price it would accept on to his principal, Mr. Soulos?

10 At trial Mr. Soulos' only claim was that the property be transferred to him for the price paid by Mr. Korkontzilas, subject to adjustments for changes in value and losses incurred on the property since purchase. He abandoned his claim for damages at an early stage of the proceedings. This is not surprising, since Mr. Korkontzilas had paid market value for the property and had, in fact, lost money on it during the period he had held it. Still, Mr. Soulos maintained his desire to own the property.

11 Mr. Soulos argued that the property should be returned to him under the equitable doctrine of constructive trust. The trial judge rejected this claim, on the ground that constructive trust arises only where the defendant has been unjustly enriched by his wrongful act. The fact that damages offered Mr. Soulos no compensation was of no moment: "It would be anomalous to declare a constructive trust, in effect, because a remedy in damages is unsatisfactory, the plaintiff having suffered none" (p. 69). Furthermore, "it seems simply disproportionate and inappropriate to utilize the drastic remedy of a constructive trust where the plaintiff has suffered no damage" (p. 69). The trial judge added that nominal damages were inappropriate, damages having been waived, and that Mr. Soulos had mitigated his loss by buying other properties.

12 The majority of the Court of Appeal took a different view. Carthy J.A. held that the award of an equitable remedy is discretionary and dependent on all the facts before the court. In his view, however, the trial judge had exercised his discretion on a wrong principle. Carthy J.A. asserted that the moral quality of the defendant's act may dictate the court's intervention. Most real estate transactions involve one person acting gratuitously for the purchaser, while seeking commission from the vendor. The fiduciary duties of the agent would be meaningless if the agent could simply acquire the property at market value, and then deny that he or she is a constructive trustee because no damages are suffered. In such circumstances, equity will "intervene with a proprietary remedy to sustain the integrity of the laws which it supervises" (p. 261). Carthy J.A. conceded that Mr. Soulos' reason for desiring the property may seem "whimsical". But viewed against the broad context of real estate transactions, he found that the remedy of constructive trust in these circumstances serves a "salutary purpose". It enables the court to ensure that

immoral conduct is not repeated, undermining the bond of trust that enables the industry to function. The majority accordingly ordered conveyance of the property subject to appropriate adjustments.

13 The difference between the trial judge and the majority in the Court of Appeal may be summarized as follows. The trial judge took the view that in the absence of established loss, Mr. Soulos had no action. To grant the remedy of constructive trust in the absence of loss would be "simply disproportionate and inappropriate", in his view. The majority in the Court of Appeal, by contrast, took a broader view of when a constructive trust could apply. It held that a constructive trust requiring reconveyance of the property could arise in the absence of an established loss in order to condemn the agent's improper act and maintain the bond of trust underlying the real estate industry and hence the "integrity of the laws" which a court of equity supervises.

14 The appeal thus presents two different views of the function and ambit of the constructive trust. One view sees the constructive trust exclusively as a remedy for clearly established loss. On this view, a constructive trust can arise only where there has been "enrichment" of the defendant and corresponding "deprivation" of the plaintiff. The other view, while not denying that the constructive trust may appropriately apply to prevent unjust enrichment, does not confine it to that role. On this view, the constructive trust may apply absent an established loss to condemn a wrongful act and maintain the integrity of the relationships of trust which underlie many of our industries and institutions.

15 It is my view that the second, broader approach to constructive trust should prevail. This approach best accords with the history of the doctrine of constructive trust, the theory underlying the constructive trust, and the purposes which the constructive trust serves in our legal system.

V

16 The appellants argue that this Court has adopted a view of constructive trust based exclusively on unjust enrichment in cases such as *Becker v. Pettkus*, [1980] 2 S.C.R. 834 (S.C.C.). Therefore, they argue, a constructive trust cannot be imposed in cases like this where the plaintiff can demonstrate no deprivation and corresponding enrichment of the defendant.

17 The history of the law of constructive trust does not support this view. Rather, it suggests that the constructive trust is an ancient and eclectic institution imposed by law not only to remedy unjust enrichment, but to hold persons in different situations to high standards of trust and probity and prevent them from retaining property which in "good conscience" they should not be permitted to retain. This served the end, not only of doing justice in the case before the court, but of protecting relationships of trust and the institutions that depend on these relationships. These goals were accomplished by treating the person holding the property as a trustee of it for the wronged person's benefit, even though there was no true trust created by intention. In England, the trust thus created was thought of as a real or "institutional" trust. In the United States and recently in Canada, jurisprudence speaks of the availability of the constructive trust as a remedy; hence the remedial constructive trust.

18 While specific situations attracting a constructive trust have been identified, the older English jurisprudence offers no satisfactory limiting or unifying conceptual theory for the constructive trust. As D. W. M. Waters, *The Constructive Trust* (1964), at p. 39, puts it, the constructive trust "was never any more than a convenient and available language medium through which ... the obligations of parties might be expressed or determined". The constructive trust was used in English law "to link together a number of disparate situations ... on the basis that the obligations imposed by law in these situations might in some way be likened to the obligations which were imposed upon an express trustee": J. L. Dewar, "The Development of the Remedial Constructive Trust" (1981), 6 *Est. & Tr. Q.* 312, at p. 317, citing Waters, *supra*.

19 The situations in which a constructive trust was recognized in England include constructive trusts arising on breach of a fiduciary relationship, as well as trusts imposed to prevent the absence of writing from depriving a person of proprietary rights, to prevent a purchaser with notice from fraudulently retaining trust properties, and to enforce secret trusts and mutual wills. See Dewar, *supra*, at p. 334. The fiduciary relationship underlies much of the English law of constructive trust. As Waters, *supra*, at p. 33, writes: "the fiduciary relationship is clearly wed to the constructive trust over the whole, or little short of the whole, of the trust's operation". At the same time, not all breaches of fiduciary relationships give rise to a constructive trust. As L. S. Sealy, "Fiduciary Relationships", [1962] *Camb. L.J.* 69, at p. 73, states:

> The word "fiduciary," we find, is *not* definitive of a single class of relationships to which a fixed set of rules and principles apply. Each equitable remedy is available only in a limited number of fiduciary situations; and the mere statement that John is in a fiduciary relationship towards me means no more than that in some respects his position is trustee-like; it does not warrant the inference that any particular fiduciary principle or remedy can be applied. [Emphasis in original.]

Nor does the absence of a classic fiduciary relationship necessarily preclude a finding of a constructive trust; the wrongful nature of an act may be sufficient to constitute breach of a trust-like duty: see Dewar, *supra*, at pp. 322-23.

20 Canadian courts have never abandoned the principles of constructive trust developed in England. They have, however, modified them. Most notably, Canadian courts in recent decades have developed the constructive trust as a remedy for unjust enrichment. It is now established that a constructive trust may be imposed in the absence of wrongful conduct like breach of fiduciary duty, where three elements are present: (1) the enrichment of the defendant; (2) the corresponding deprivation of the plaintiff; and (3) the absence of a juristic reason for the enrichment: *Becker v. Pettkus, supra.*

21 This Court's assertion that a remedial constructive trust lies to prevent unjust enrichment in cases such as *Becker v. Pettkus* should not be taken as expunging from Canadian law the constructive trust in other circumstances where its availability has long been recognized. The language used makes no such claim. A. J. McClean, "Constructive and Resulting Trusts — Unjust Enrichment in a Common Law Relationship — *Pettkus v. Becker*" (1982), 16 *U.B.C.L. Rev.* 156 at p. 170, describes the ratio of *Becker v. Pettkus* as "a modest enough proposition". He goes on: "It would be wrong ... to read it as one would read the language of a statute and limit further development of the law".

22 Other scholars agree that the constructive trust as a remedy for unjust enrichment does not negate a finding of a constructive trust in other situations. D. M. Paciocco, "The Remedial Constructive Trust: A Principled Basis for Priorities over Creditors, (1989), 68 *Can. Bar Rev.* 315, at p. 318, states: "the constructive trust that is used to remedy unjust enrichment must be distinguished from the other types of constructive trusts known to Canadian law prior to 1980". Paciocco asserts that unjust enrichment is not a necessary condition of a constructive trust (at p. 320):

> ... in the largest traditional category, the fiduciary constructive trust, there need be no deprivation experienced by the particular plaintiff. The constructive trust is imposed to raise the morality of the marketplace generally, with the beneficiaries of some of these trusts receiving what can only be described as a windfall.

23 Dewar, *supra*, holds a similar view (at p. 332):

> While it is unlikely that Canadian courts will abandon the learning and the classifications which have grown up in connection with the English constructive trust, it is submitted that the adoption of the American style constructive trust by the Supreme Court of Canada in *Pettkus v. Becker* will profoundly influence the future development of Canadian trust law.

Dewar, *supra*, at pp. 332-33, goes on to state: "In English and Canadian law there is no general agreement as to precisely which situations give rise to a constructive trust, although there are certain general categories of cases in which it is agreed that a constructive trust does arise". One of these is to correct fraudulent or disloyal conduct.

24 M. M. Litman, "The Emergence of Unjust Enrichment as a Cause of Action and the Remedy of Constructive Trust", (1988), 26 *Alta. L. Rev.* 407, at p. 414, sees unjust enrichment as a useful tool in rationalizing the traditional categories of constructive trust. Nevertheless he opines that it would be a "significant error" to simply ignore the traditional principles of constructive trust. He cites a number of Canadian cases subsequent to *Becker v. Pettkus, supra*, which impose constructive trusts for wrongful acquisition of property, even in the absence of unjust enrichment and correlative deprivation, and concludes that the constructive trust "cannot always be explained by the unjust enrichment model of constructive trust" (p. 416). In sum, the old English law remains part of contemporary Canadian law and guides its development. As La Forest J.A. (as he then was) states in *White v. Central Trust Co.* (1984), 17 E.T.R. 78 (N.B. C.A.), at p. 90, cited by Litman, *supra*, the courts "will not venture far onto an uncharted sea when they can administer justice from a safe berth".

25 I conclude that the law of constructive trust in the common law provinces of Canada embraces the situations in which English courts of equity traditionally found a constructive trust as well as the situations of unjust enrichment recognized in recent Canadian jurisprudence.

VI

26 Various principles have been proposed to unify the situations in which the English law found constructive trust. R. Goff and G. Jones, *The Law of Restitution* (3rd ed. 1986), at p. 61, suggest that unjust enrichment is such a theme. However, unless "enrichment" is interpreted very broadly to extend beyond pecuniary claims, it does not explain all situations in which the constructive trust has been applied. As McClean, *supra*, at p. 168, states: "however satisfactory [the unjust enrichment theory] may be for other aspects of the law of restitution, it may not be wide enough to cover all types of constructive trust." McClean goes on to note the situation raised by this appeal: "In some cases, where such a trust is imposed the trustee may not have obtained any benefit at all; this could be the case, for example, when a person is held to be a trustee *de son tort*. A plaintiff may not always have suffered a loss." McClean concludes (at pp. 168-69): "Unjust enrichment may not, therefore, satisfactorily explain all types of restitutionary claims".

27 McClean, among others, regards the most satisfactory underpinning for unjust enrichment to be the concept of "good conscience" which lies at "the very foundation of equitable jurisdiction" (p. 169):

> "Safe conscience" and "natural justice and equity" were two of the criteria referred to by Lord Mansfield in *Moses v. MacFerlan* (1760), 2 Burr. 1005, 97 E.R. 676 (K.B.) in dealing with an action for money had and received, the prototype of a common law restitutionary claim. "Good conscience" has a sound basis in equity, some basis in common law, and is wide enough to encompass constructive trusts where the defendant has not obtained a benefit or where the plaintiff has not suffered a loss. It is, therefore, as good as, or perhaps a better, foundation for the law of restitution than is unjust enrichment.

28 Other scholars agree with McClean that good conscience may provide a useful way of unifying the different forms of constructive trust. Litman, *supra*, adverts to the "natural justice and equity" or "good conscience" trust "which operates as a remedy for wrongs which are broader in concept than unjust enrichment" and goes on to state that this may be viewed as the underpinning of the various institutional trusts as well as the unjust enrichment restitutionary constructive trust (at pp. 415-16).

29 Good conscience as the unifying concept underlying constructive trust has attracted the support of many jurists. Edmund Davies L.J. suggested that the concept of a "want of probity" in the person upon whom the constructive trust is imposed provides "a useful touchstone in considering circumstances said to give rise to constructive trusts": *Carl-Zeiss-Stiftung v. Herbert Smith & Co. (No. 2)*, [1968] 2 Ch. 276 (Eng. C.A.). Cardozo J. similarly endorsed the unifying theme of good conscience in *Beatty v. Guggenheim Exploration Co.*, 122 N.E. 378 (U.S. 1919), at p. 380:

> A constructive trust is the formula through which the conscience of equity finds expression. *When property has been acquired in such circumstances that the holder of the legal title may not in good conscience retain the beneficial interest, equity converts him into a trustee.* [Emphasis added.]

30 Lord Denning M.R. expressed similar views in a series of cases applying the constructive trust as a remedy for wrongdoing: see *Neale v. Willis* (1968), 112 Sol. Jo. 521 (Eng. C.A.); *Binions v. Evans*, [1972] Ch. 359 (Eng. C.A.); *Hussey v. Palmer*, [1972] 1 W.L.R. 1286 (Eng. C.A.). In *Binions*, referring to the statement by Cardozo J., *supra*, Denning M.R. stated that the court would impose a constructive trust "for the simple reason that it would be utterly inequitable for the plaintiffs to turn the defendant out contrary to the stipulation subject to which they took the premises" (p. 368). In *Hussey*, he said the following of the constructive trust (at pp. 1289-90): "By whatever name it is described, it is a trust imposed by law whenever justice and good conscience require it".

31 Many English scholars have questioned Lord Denning's expansive statements on constructive trust. Nevertheless, he is not alone: Bingham J. similarly referred to good conscience as the basis for equitable intervention in *Neste Oy v. Lloyd's Bank Ltd.*, [1983] 2 Lloyd's Rep. 658 (Eng. C.A.).

32 The New Zealand Court of Appeal also appears to have accepted good conscience as the basis for imposing a constructive trust in *Elders Pastoral Ltd. v. Bank of New Zealand* (1989), 2 N.Z.L.R. 180. Cooke P., at pp. 185-86, cited the following passage from Bingham J.'s reasons in *Neste Oy, supra*, at p. 666:

> Given the situation of [the defendants] when the last payment was received, any reasonable and honest directors of that company (or the actual directors had they known of it) would, I feel sure, have arranged for the repayment of that sum to the plaintiffs without hesitation or delay. It would have seemed little short of sharp practice for [the defendants] to take any benefit from the payment, and it would have seemed contrary to any ordinary notion of fairness that the general body of creditors should profit from the accident of a payment made at a time when there was bound to be a total failure of consideration. Of course it is true that insolvency always causes loss and perfect fairness is unattainable. The bank, and other creditors, have their legitimate claims. *It nonetheless seems to me that at the time of its receipt [the defendants] could not in good conscience retain this payment and that accordingly a constructive trust is to be inferred.* [Emphasis added.]

Cooke P. concluded simply (at p. 186): "I do not think that in conscience the stock agents can retain this money." *Elders* has been taken to stand for the proposition that even in the absence of a fiduciary relationship or unjust enrichment, conduct contrary to good conscience may give rise to a remedial constructive trust: see *Mogal Corp. v. Australasia Investment Co. (In Liquidation)* (1990), 3 N.Z.B.L.C. 101, 783; J. Dixon, "The Remedial Constructive Trust Based on Unconscionability in the New Zealand Commercial Environment" (1995), 7 *Auck. U. L. Rev.* 147, at pp. 157-58. Although the Judicial Committee of the Privy Council rejected the creation of a constructive trust on grounds of good conscience in *Goldcorp Exchange Ltd., Re*, [1994] 2 All E.R. 806 (New Zealand P.C.), the fact remains that good conscience is a theme underlying constructive trust from its earliest times.

33 Good conscience addresses not only fairness between the parties before the court, but the larger public concern of the courts to maintain the integrity of institutions like fiduciary relationships which the courts of equity supervised. As La Forest J. states in *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 (S.C.C.), at p. 453:

> The law of fiduciary duties has always contained within it an element of deterrence. This can be seen as early as *Keech* in the passage cited *supra*; see also *Canadian Aero, supra*, at pp. 607 and 610; *Canson, supra*, at p. 547, *per* McLachlin J. In this way the law is able to monitor a given relationship society views as socially useful while avoiding the necessity of formal regulation that may tend to hamper its social utility.

The constructive trust imposed for breach of fiduciary relationship thus serves not only to do the justice between the parties that good conscience requires, but to hold fiduciaries and people in positions of trust to the high standards of trust and probity that commercial and other social institutions require if they are to function effectively.

34 It thus emerges that a constructive trust may be imposed where good conscience so requires. The inquiry into good conscience is informed by the situations where constructive trusts have been recognized in the past. It is also informed by the dual reasons for which constructive trusts have traditionally been imposed: to do justice between the parties and to maintain the integrity of institutions dependent on trust-like relationships. Finally, it is informed by the absence of an indication that a constructive trust would have an unfair or unjust effect on the defendant or third parties, matters which equity has always taken into account. Equitable remedies are flexible; their award is based on what is just in all the circumstances of the case.

35 Good conscience as a common concept unifying the various instances in which a constructive trust may be found has the disadvantage of being very general. But any concept capable of embracing the diverse circumstances in which a constructive trust may be imposed must, of necessity, be general. Particularity is found in the situations in which judges in the past have found constructive trusts. A judge faced with a claim for a constructive trust will have regard not merely to what might seem "fair" in a general sense, but to other situations where courts have found a constructive trust. The goal is but a reasoned, incremental development of the law on a case-by-case basis.

36 The situations which the judge may consider in deciding whether good conscience requires imposition of a constructive trust may be seen as falling into two general categories. The first category concerns property obtained by a wrongful act of the defendant, notably breach of fiduciary obligation or breach of duty of loyalty. The traditional English institutional trusts largely

fall under but may not exhaust (at least in Canada) this category. The second category concerns situations where the defendant has not acted wrongfully in obtaining the property, but where he would be unjustly enriched to the plaintiff's detriment by being permitted to keep the property for himself. The two categories are not mutually exclusive. Often wrongful acquisition of property will be associated with unjust enrichment, and vice versa. However, either situation alone may be sufficient to justify imposition of a constructive trust.

37 In England the law has yet to formally recognize the remedial constructive trust for unjust enrichment, although many of Lord Denning's pronouncements pointed in this direction. The courts do, however, find constructive trusts in circumstances similar to those at bar. Equity traditionally recognized the appropriateness of a constructive trust for breach of duty of loyalty simpliciter. The English law is summarized by Goff and Jones, *The Law of Restitution, supra*, at p. 643:

> A fiduciary may abuse his position of trust by diverting a contract, purchase or other opportunity from his beneficiary to himself. If he does so, he is deemed to hold that contract, purchase, or opportunity on trust for the beneficiary.

P. Birks, *An Introduction to the Law of Restitution* (1985) (at pp. 330; 338-43) agrees. He suggests that cases of conflict of interest not infrequently may give rise to constructive trust, absent unjust enrichment. Birks distinguishes between anti-enrichment wrongs and anti-harm wrongs (at p. 340). A fiduciary acting in conflict of interest represents a risk of actual or potential harm, even though his misconduct may not always enrich him. A constructive trust may accordingly be ordered.

38 Both categories of constructive trust are recognized in the United States; although unjust enrichment is sometimes cited as the rationale for the constructive trust in the U.S., in fact its courts recognize the availability of constructive trust to require the return of property acquired by wrongful act absent unjust enrichment of the defendant and reciprocal deprivation of the plaintiff. Thus the authors of *Scott on Trusts* (3rd ed. 1967), vol. V, at p. 3410, state that the constructive trust "is available where property is obtained by mistake or by fraud or by other wrong". Or as Cardozo C.J. put it, "[a] constructive trust is, then, the remedial device through which preference of self is made subordinate to loyalty to others": *Meinhard v. Salmon* (1928), 164 N.E. 545 (U.S. 1928), at p. 548, cited in *Scott on Trusts, supra*, at p. 3412. *Scott on Trusts, supra*, at p. 3418, states that there are cases "in which a constructive trust is enforced against a defendant, although the loss to the plaintiff is less than the gain to the defendant or, indeed, where there is no loss to the plaintiff".

39 Canadian courts also recognize the availability of constructive trusts for both wrongful acquisition of property and unjust enrichment. Applying the English law, they have long found constructive trusts as a consequence of wrongful acquisition of property, for example by fraud or breach of fiduciary duty. More recently, Canadian courts have recognized the availability of the American-style remedial constructive trust in cases of unjust enrichment: *Becker v. Pettkus, supra*. However, since *Becker v. Pettkus* Canadian courts have continued to find constructive trusts where property has been wrongfully acquired, even in the absence of unjust enrichment. While such cases appear infrequently since few choose to litigate absent pecuniary loss, they are not rare.

40 Litman, *supra*, at p. 416, notes that in "the post-*Pettkus v. Becker* era there are numerous cases where courts have used the institutional constructive trust without adverting to or relying on unjust enrichment". The imposition of a constructive trust in these cases is justified not on grounds of unjust enrichment, but on the ground that the defendant's wrongful act requires him to restore the property thus obtained to the plaintiff.

41 Thus in *Ontario (Wheat Producers' Marketing Board) v. Royal Bank* (1984), 9 D.L.R. (4th) 729 (Ont. C.A.), a constructive trust was imposed on a bank which received money with actual knowledge that it belonged to someone other than the depositor.

42 Again, in *MacMillan Bloedel Ltd. v. Binstead* (1983), 14 E.T.R. 269 (B.C. S.C.), a constructive trust was imposed on individuals who knowingly participated in a breach of fiduciary duty despite a finding that unjust enrichment would not warrant the imposition of a trust because the plaintiff company could not be said to have suffered a loss or deprivation since its own policy precluded it from receiving the profits. Dohm J. (as he then was) stated that the constructive trust was required "not to balance the equities but to ensure that trustees and fiduciaries remain faithful and that those who assist them in the breaches of their duty are called to account" (p. 302).

43 I conclude that in Canada, under the broad umbrella of good conscience, constructive trusts are recognized both for wrongful acts like fraud and breach of duty of loyalty, as well as to remedy unjust enrichment and corresponding deprivation. While cases often involve both a wrongful act and unjust enrichment, constructive trusts may be imposed on either ground: where there is a wrongful act but no unjust enrichment and corresponding deprivation; or where there is an unconscionable unjust enrichment in the absence of a wrongful act, as in *Becker v. Pettkus, supra*. Within these two broad categories, there is room for the law of constructive trust to develop and for greater precision to be attained, as time and experience may dictate.

44 The process suggested is aptly summarized by McClean, *supra*, at pp. 167-70:

> The law [of constructive trust] may now be at a stage where it can distill from the specific examples a few general principles, and then, by analogy to the specific examples and within the ambit of the general principle, create new heads of liability. That, it is suggested, is not asking the courts to embark on too dangerous a task, or indeed on a novel task. In large measure it is the way that the common law has always developed.

VII

45 In *Becker v. Pettkus, supra*, this Court explored the prerequisites for a constructive trust based on unjust enrichment. This case requires us to explore the prerequisites for a constructive trust based on wrongful conduct. Extrapolating from the cases where courts of equity have imposed constructive trusts for wrongful conduct, and from a discussion of the criteria considered in an essay by Roy Goode, "Property and Unjust Enrichment", in Andrew Burrows ed., *Essays on the Law of Restitution* (1991), I would identify four conditions which generally should be satisfied:

> (1) The defendant must have been under an equitable obligation, that is, an obligation of the type that courts of equity have enforced, in relation to the activities giving rise to the assets in his hands;
>
> (2) The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligation to the plaintiff;
>
> (3) The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties and;
>
> (4) There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g., the interests of intervening creditors must be protected.

VIII

46 Applying this test to the case before us, I conclude that Mr. Korkontzilas' breach of his duty of loyalty sufficed to engage the conscience of the court and support a finding of constructive trust for the following reasons.

47 First, Mr. Korkontzilas was under an equitable obligation in relation to the property at issue. His failure to pass on to his client the information he obtained on his client's behalf as to the price the vendor would accept on the property and his use of that information to purchase the property instead for himself constituted breach of his equitable duty of loyalty. He allowed his own interests to conflict with those of his client. He acquired the property wrongfully, in flagrant and inexcusable breach of his duty of loyalty to Mr. Soulos. This is the sort of situation which courts of equity, in Canada and elsewhere, have traditionally treated as involving an equitable duty, breach of which may give rise to a constructive trust, even in the absence of unjust enrichment.

48 Second, the assets in the hands of Mr. Korkontzilas resulted from his agency activities in breach of his equitable obligation to the plaintiff. His acquisition of the property was a direct result of his breach of his duty of loyalty to his client, Mr. Soulos.

49 Third, while Mr. Korkontzilas was not monetarily enriched by his wrongful acquisition of the property, ample reasons exist for equity to impose a constructive trust. Mr. Soulos argues that a constructive trust is required to remedy the deprivation he suffered because of his continuing desire, albeit for non-monetary reasons, to own the particular property in question. No less

is required, he asserts, to return the parties to the position they would have been in had the breach not occurred. That alone, in my opinion, would be sufficient to persuade a court of equity that the proper remedy for Mr. Korkontzilas' wrongful acquisition of the property is an order that he is bound as a constructive trustee to convey the property to Mr. Soulos.

50 But there is more. I agree with the Court of Appeal that a constructive trust is required in cases such as this to ensure that agents and others in positions of trust remain faithful to their duty of loyalty: see *Hodgkinson v. Simms, supra, per* La Forest J. If real estate agents are permitted to retain properties which they acquire for themselves in breach of a duty of loyalty to their clients provided they pay market value, the trust and confidence which underpins the institution of real estate brokerage will be undermined. The message will be clear: real estate agents may breach their duties to their clients and the courts will do nothing about it, unless the client can show that the real estate agent made a profit. This will not do. Courts of equity have always been concerned to keep the person who acts on behalf of others to his ethical mark; this Court should continue in the same path.

51 I come finally to the question of whether there are factors which would make imposition of a constructive trust unjust in this case. In my view, there are none. No third parties would suffer from an order requiring Mr. Korkontzilas to convey the property to Mr. Soulos. Nor would Mr. Korkontzilas be treated unfairly. Mr. Soulos is content to make all necessary financial adjustments, including indemnification for the loss Mr. Korkontszilas has sustained during the years he has held the property.

52 I conclude that a constructive trust should be imposed. I would dismiss the appeal and confirm the order of the Court of Appeal that the appellants convey the property to the respondent, subject to appropriate adjustments. The respondent is entitled to costs throughout.

***Sopinka J.* (dissenting) (Iacobucci J. concurring):**

53 I have read the reasons of my colleague McLachlin J. While I agree with her conclusion that a breach of a fiduciary duty was made out herein, I disagree with her analysis concerning the appropriate remedy. In my view, she errs in upholding the decision of the majority of the Court of Appeal to overturn the trial judge and impose a constructive trust over the property in question. There are two broad reasons for my conclusion. First, the order of a constructive trust is a discretionary matter and, as such, is entitled to appellate deference. Given that the trial judge did not err in principle in declining to make such an order, appellate courts should not interfere with the exercise of his discretion. Second, even if appellate review were appropriate in the present case, a constructive trust as a remedy is not available where there has been no unjust enrichment. The main source of my disagreement with McLachlin J. arises in consideration of the second point, but in order to address the reasons of the majority in the court below as well, I will consider both of these issues in turn.

Standard of Review and the Exercise of Discretion

54 It is a matter of settled law that appellate courts should generally not interfere with orders exercised within a trial judge's discretion. Only if the discretion has been exercised on the basis of an erroneous principle should the order be overturned on appeal: see *Donkin v. Bugoy*, [1985] 2 S.C.R. 85 (S.C.C.). As acknowledged by the majority in the Court of Appeal ((1995), 25 O.R. (3d) 257 (Ont. C.A.), at p. 259), the decision to order a constructive trust is a matter of discretion. In *International Corona Resources Ltd. v. LAC Minerals Ltd.*, [1989] 2 S.C.R. 574 (S.C.C.), the majority held that the order of a constructive trust in response to a breach of a fiduciary duty would depend on all the circumstances. La Forest J. stated at p. 674:

> In the case at hand, the restitutionary claim has been made out. The Court can award either a proprietary remedy, namely that Lac hand over the Williams property, or award a personal remedy, namely a monetary award. ... [A constructive trust] is but one remedy, and will only be imposed in appropriate circumstances.

The discretionary approach to constructive trusts is also consistent with the approach to equitable remedies generally: see *Canson Enterprises Ltd. v. Boughton & Co.*, [1991] 3 S.C.R. 534 (S.C.C.), at p. 585.

55 Given that ordering a constructive trust is a discretionary matter, it is necessary to show an error in principle on the part of the trial judge in order to overturn the judge's decision not to order such a remedy. In my view, the trial judge committed no such error.

56 The majority of the Court of Appeal apparently found that the trial judge erred in failing to consider the moral blameworthiness of the appellants' actions. Similarly, McLachlin J. would hold that a constructive trust was appropriate in the present case simply because of considerations of "good conscience". In my view, the trial judge considered the moral quality of the appellants' actions and thus there is no room for appellate intervention on this ground. He stated ((1991), 4 O.R. (3d) 51 (Ont. Gen. Div.), at p. 69) that, while "[n]o doubt the maintenance of commercial morality is an element of public policy and a legitimate concern of the court", morality should generally not invite the intervention of the court, except where it is required in aid of enforcing some legal right. Put another way, in my view the trial judge was of the opinion that where there is otherwise no justification for ordering a constructive trust or any other remedy, the morality of the act will not alone justify such an order, which statement of the law is in my view correct.

57 The majority of the Court of Appeal stated (at pp. 259-60) that the principles set out by the trial judge may be applicable where there are alternative remedies, but are questionable where only one remedy is available, as in the present case. I do not accept this contention. If a constructive trust is held to be inappropriate where there are a variety of remedies available, I cannot understand the principle behind the conclusion that such a remedy may be appropriate where it is the only remedy available. The trial judge has a discretion to order a constructive trust, or not to order one, and this discretion should not be affected by the number of available remedies. In the present case, the plaintiff withdrew his claim for damages. While compensatory damages were unavailable since the plaintiff suffered no pecuniary loss (which I will discuss further below in assessing whether a constructive trust could have been ordered), the plaintiff could have sought exemplary damages — his decision not to do so should not bind the trial judge's discretion with respect to the order of a constructive trust.

58 The trial judge put significant emphasis on the absence of pecuniary gains in concluding that he would not order a constructive trust. For the reasons which I set out in detail below, I am of the opinion that the trial judge was correct in this regard. On the other hand, the majority of the Court of Appeal and McLachlin J. hold that the trial judge erred in improperly appreciating the deterrence role of a constructive trust in the present case. In my view, consideration of deterrence fails to disclose any error in principle on the part of the trial judge. Deterrence, like the morality of the acts in question, may be relevant to the exercise of discretion with respect to the remedy for a breach of a fiduciary duty (see, e.g., *Hodgkinson v. Simms*, [1994] 3 S.C.R. 377 (S.C.C.), at pp. 421 and 453), but the trial judge in the present case did not fail to consider deterrence in deciding whether to order a constructive trust. As noted above, he stated that while "maintenance of commercial morality is ... a legitimate concern of the court" (p. 69), it would not alone justify ordering a remedy in the present case. In my view, his mention of the "maintenance of commercial morality" indicates that the judge considered deterrence, but held that it alone could not justify a remedy in the present case. Thus, even if failure to consider deterrence could be considered an error in principle, the trial judge in the present case did not so err.

59 In my view, the trial judge committed no error in principle which could justify a decision to set aside his judgment and order a constructive trust. Even if the trial judge did commit some error in principle, however, in my view the remedy of a constructive trust was not available on the facts of the present case. That is, even if no deference is owed to the trial judge, the majority below erred in ordering a constructive trust and the appeal should be allowed. The following are my reasons for this conclusion.

Unjust Enrichment and the Availability of a Constructive Trust

60 McLachlin J. would hold that there are two general circumstances in which a constructive trust may be ordered: where there has been unjust enrichment and where there has been an absence of "good conscience". While unjust enrichment and the absence of "good conscience" may both be present in a particular case, McLachlin J. is of the view that either element individually is sufficient to order a constructive trust. By failing to consider the "good conscience" ground on its own, McLachlin J. finds that the trial judge erred. I respectfully disagree with this finding. In my view, recent case law in this Court is very clear that a constructive trust may *only* be ordered where there has been an unjust enrichment. For example, passages in *LAC Minerals, supra*, set out the circumstances in which an order of a constructive trust might be appropriate. In my opinion, it is clear from that decision that a constructive trust is not available as a remedy unless there has been an unjust enrichment. La Forest J. stated at pp. 673-74:

> This Court has recently had occasion to address the circumstances in which a constructive trust will be imposed in *Hunter Engineering Co. v. Syncrude Canada Ltd.*, [1989] 1 S.C.R. 426. There, the Chief Justice discussed the development of the constructive trust over 200 years from its original use in the context of fiduciary relationships, through to *Pettkus v. Becker*, [[1980] 2 S.C.R. 834], where the Court moved to the modern approach with the constructive trust as a remedy for unjust enrichment. He identified that *Pettkus v. Becker, supra*, set out a two-step approach. *First, the Court determines whether a claim for unjust enrichment is established, and then, secondly, examines whether in the circumstances a constructive trust is the appropriate remedy to redress that unjust enrichment.* In *Hunter Engineering Co. v. Syncrude Canada Ltd.*, a constructive trust was refused, not on the basis that it would not have been available between the parties (though in my view it may not have been appropriate), but rather on the basis that the claim for unjust enrichment had not been made out, so no remedial question arose.
>
> In the case at hand, the restitutionary claim has been made out. The Court can award either a proprietary remedy, namely that Lac hand over the Williams property, or award a personal remedy, namely a monetary award. While, as the Chief Justice observed, "*The principle of unjust enrichment lies at the heart of the constructive trust*": see *Pettkus v. Becker*, at p. 847, the converse is not true. The constructive trust does not lie at the heart of the law of restitution. [Emphasis added.]

La Forest J. added at p. 678:

> *Much of the difficulty disappears if it is recognized that in this context the issue of the appropriate remedy only arises once a valid restitutionary claim has been made out.* The constructive trust awards a right in property, but that right can only arise once a right to relief has been established. [Emphasis added.]

61 In *Brissette v. Westbury Life Insurance Co.*, [1992] 3 S.C.R. 87 (S.C.C.), the majority cited some of the passages above from *Lac* with approval and held at p. 96 that, "[t]he requirement of unjust enrichment is fundamental to the use of a constructive trust."

62 Citing only *Pettkus, supra*, specifically, McLachlin J. states at para. 21 that it and other cases should not be taken to expunge from Canadian law the constructive trust in circumstances where there has not been unjust enrichment. With respect, I do not see how statements such as "The requirement of unjust enrichment is fundamental to the use of a constructive trust" could do anything but expunge from Canadian law the use of constructive trusts where there has been no enrichment. Unjust enrichment has been repeatedly stated to be a *requirement* for a constructive trust; thus to order one where there has been no unjust enrichment would clearly depart from settled law.

63 Even aside from the case law, in my view, the unavailability of a constructive trust in the absence of unjust enrichment is consistent with the constructive trust's remedial role. The respondent submitted that if no remedy is available in the present case, there would inappropriately be a right without a remedy. I disagree. Clearly, the beneficiary has a right to have the fiduciary adhere to its duty, and *if damages are suffered*, the beneficiary has a right to a remedy. In my view, this is analogous to remedial principles found elsewhere in the private law. Even if a duty is owed and breached in other legal contexts, there is no remedy unless a loss has been suffered. I may owe a duty to my neighbour to shovel snow off my walk, and I may breach that duty, but if my neighbour does not suffer any loss because of the breached duty, there is no tort and no remedy. Similarly, I may have a contractual duty to supply goods at a specific date for a specific price, but if I do not and the other party is able to purchase the same goods at the contract price at the same time and place, the party has not suffered damage and no remedy is available. It is entirely consistent with these rules to state that even if a fiduciary breaches a duty, if the fiduciary is not unjustly enriched by the breach, there is no remedy.

64 Remedial principles generally thus support the rule against a constructive trust where there has been no unjust enrichment. The rule is also supported, in my view, by specific consideration of the principles governing constructive trusts set out in *LAC Minerals*. In *LAC Minerals*, La Forest J. stated that, even where there has been unjust enrichment, the constructive trust will be an exceptional remedy; the usual approach would be to award damages. He stated at p. 678:

> In the vast majority of cases a constructive trust will not be the appropriate remedy. Thus, in *Hunter Engineering Co. v. Syncrude Canada Ltd., supra*, had the restitutionary claim been made out, there would have been no reason to award a constructive trust, as the plaintiff's claim could have been satisfied simply by a personal monetary award; *a constructive trust should only be awarded if there is reason to grant to the plaintiff the additional rights that flow from recognition of a right of property*. [Emphasis added.]

65 La Forest J. thus held that generally an aggrieved beneficiary will only be entitled to damages, not to the property itself. This implies that the beneficiary does not generally have a right to the property in question, but rather has a right to receive the value of the gains resulting from the acquisition of the property. Following this reasoning, if the value of the gains is zero, that is, there is no unjust enrichment, the beneficiary will not have a right to a remedy. Consequently, where there has been no unjust enrichment, there is no right to a constructive trust or any other remedy.

66 While, in my view, recent decisions of this Court and the principles underlying them settle the matter, McLachlin J. cites other Canadian case law in concluding that constructive trusts may be ordered even where there has not been unjust enrichment. She cites three lower court decisions which she claims involved the award of a constructive trust absent unjust enrichment. With respect, I do not read any one of these cases as supporting her claim. An unjust enrichment exists where there has been an enrichment of the defendant, a corresponding deprivation experienced by the plaintiff and the absence of any juristic reason for the enrichment: *Becker v. Pettkus*, [1980] 2 S.C.R. 834 (S.C.C.); *Syncrude Canada Ltd. v. Hunter Engineering Co.*, [1989] 1 S.C.R. 426 (S.C.C.). McLachlin J. fails to cite a case where a remedial constructive trust was ordered absent such an enrichment.

67 In *Ontario (Wheat Producers' Marketing Board) v. Royal Bank* (1984), 9 D.L.R. (4th) 729 (Ont. C.A.), a constructive trust was imposed on a bank which received money with actual knowledge that it belonged to someone other than the depositor. The bank was a secured creditor of the depositor, which depositor was in financial difficulty at the time of the deposits. Clearly, this case involved an unjust enrichment: the bank benefitted by gaining rights over the deposited money, as well as by increasing the likelihood of repayment of the depositor's credit; the plaintiff (a corporation whose agent, the depositor, breached his fiduciary obligations) was deprived of its right to its money; and there was no juristic reason for the enrichment. Thus, the order of a constructive trust responded to an unjust enrichment, whether or not the court adverted to such doctrine.

68 *MacMillan Bloedel Ltd. v. Binstead* (1983), 14 E.T.R. 269 (B.C. S.C.) is also, in my view, a case of unjust enrichment. In this case, a fiduciary to a corporation breached his duty by engaging in self-dealing without disclosing his interest. A constructive trust was imposed over the secret profits even though the plaintiff organization, because of its internal policy, could not have realized the profits itself. While the fiduciary was plainly enriched, the trial judge and McLachlin J. conclude that since the plaintiff could not have realized the profits, there was no "corresponding deprivation" and therefore no unjust enrichment.

69 I disagree with McLachlin J. that there was no unjust enrichment in *MacMillan Bloedel Ltd.* First of all, courts have consistently treated fiduciaries' profits explicitly as unjust enrichment, whether or not the beneficiary could have earned the profits itself. For example, in *Reading v. R.*, [1948] 2 All E.R. 27 (Eng. K.B.), aff'd [1949] 2 All E.R. 68 (Eng. C.A.), aff'd [1951] 1 All E.R. 617 (Eng. H.L.), Denning J. stated at p. 28:

> It matters not that the master has not lost any profit, nor suffered any damage, nor does it matter that the master could not have done the act himself. If the servant has *unjustly enriched himself* by virtue of his service without his master's sanction, the law says that he ought not to be allowed to keep the money. ... [Emphasis added.]

In *Canadian Aero Service Ltd. v. O'Malley* (1973), [1974] S.C.R. 592 (S.C.C.), at pp. 621-22, Laskin J., as he then was, stated:

> Liability of O'Malley and Zarzycki for breach of fiduciary duty *does not depend upon proof by Canaero that, but for their intervention, it would have obtained the Guyana contract*; nor is it a condition of recovery of damages that Canaero establish what its profit would have been or what it has lost by failing to realize the corporate opportunity in question. It is entitled to compel the faithless fiduciaries to answer for their default according to their gain. Whether the damages awarded here be viewed as an accounting of profits or, what amounts to the same thing, *as based on unjust enrichment*, I would not interfere with the quantum. [Emphasis added.]

Reading and *Canadian Aero Service Ltd.* are clear: the characterization of the profits earned by a fiduciary in breach of duty is one of unjust enrichment, whether or not the corporation could have earned the profits itself. Thus, *MacMillan Bloedel Ltd.* involved unjust enrichment, contrary to McLachlin J.'s assertion.

70 I wish to add that the treatment of the profits as unjust enrichment in *Reading, O'Malley*, and *MacMillan Bloedel Ltd.* is not inconsistent with the general rules governing unjust enrichment. The plaintiff in each case had a right to have the fiduciary adhere to his duty. When the defendant breached that duty, the profits earned as a result of that breach are essentially treated in equity as belonging to the corporation, whether or not the corporation could have earned those profits in the absence of the breach. As an example of the proprietary analogy, Denning M.R. stated at p. 856 in *Phipps v. Boardman*, [1965] 1 All E.R. 849 (Eng. C.A.), aff'd [1966] 3 All E.R. 721 (U.K. H.L.), that:

> [W]ith *information or knowledge* which he has been employed by his principal to collect or discover, *or which he has otherwise acquired*, for the use of his principal, then again if he turns it to his own use, so as to make a profit by means of it for himself, *he is accountable ... for such information or knowledge is the property of his principal, just as much as an invention is*. ... [Italics in original; underlining added.]

71 Thus, in *MacMillan Bloedel Ltd.*, the retention of the profits by the fiduciary would have deprived the corporation of its right to the profits. The deprivation is represented by the monies obtained by the fiduciary as a result of infringing the rights of the plaintiff. In order for there not to have been deprivation and unjust enrichment in circumstances otherwise similar to *MacMillan Bloedel Ltd.*, the self-dealing could not have resulted in any secret profits — if a remedy were awarded in a case without profit, thus no enrichment nor deprivation, McLachlin J. could well point to the case for support. Given that there *was* profit in *MacMillan Bloedel Ltd.*, however, there was unjust enrichment which justified the order of a constructive trust, whether or not the court explicitly relied upon unjust enrichment.

72 In summary, McLachlin J. fails to refer to a single Canadian case where a constructive trust was ordered despite the absence of unjust enrichment. Given this conclusion and given that recent cases of this Court unambiguously foreclose the possibility of ordering a constructive trust in the absence of unjust enrichment, in my view McLachlin J. is in error in concluding that a constructive trust may be ordered in the absence of unjust enrichment.

73 Aside from Canadian case law, McLachlin J. attempts to rely on various scholars and foreign case law as providing support for her conclusion. Because of the clear statement of the law recently set out by this Court, in my view the scholarly writings and foreign cases are only useful insofar as the policy they set out suggests that the law in Canada should be modified. I will therefore simply address the policy upon which McLachlin J. relies, rather than each case and each article she cites.

74 Simply put, McLachlin J., reasoning similarly to the majority below, concludes that to fail to permit the order of a constructive trust where there has been a breach of a fiduciary duty, but no unjust enrichment, would inadequately safeguard the integrity of fiduciary relationships. She says at para. 33 that ordering a constructive trust simply on the basis of "good conscience",

> addresses not only fairness between the parties before the court, but the larger public concern of the courts to maintain the integrity of institutions like fiduciary relationships which the courts of equity supervised. ... The constructive trust imposed for breach of fiduciary relationship, thus serves not only to do the justice between the parties that good conscience requires, but to hold fiduciaries and people in positions of trust to the high standards of trust and probity that commercial and other social institutions require if they are to function effectively.

According to McLachlin J., then, deterrence of faithless fiduciaries requires the availability of constructive trust as a remedy even where there has been no unjust enrichment.

75 In my view, deterrence is not a factor which suggests modifying the law of Canada and permitting the order of a constructive trust even where there has been no unjust enrichment. As noted above, despite considerations of deterrence, it is true throughout the private law that remedies are typically unavailable in the absence of a loss. Courts have not, because of

concern about protecting the integrity of these duties, held it to be necessary where a tort duty, or a contractual duty, has been breached to order remedies even where no loss resulted. I fail to see what distinguishes the role of fiduciary duties from the very important societal roles played by other legal duties which would justify their exceptional treatment with respect to remedy.

76 In any event, the unavailability of a constructive trust in cases where there is no unjust enrichment does not, in my opinion, have any significant effect on deterring unfaithful fiduciaries and protecting the integrity of fiduciary relationships. First, if deterrence were deemed to be particularly important in a case, the plaintiff may seek and the trial judge may award exemplary damages; a constructive trust is not necessary to preserve the integrity of the relationship, even if this integrity were of particular concern in a given case. The fact that exemplary damages were not sought in the present case should not compel this Court to order a constructive trust in their place. Second, even if a remedy were unavailable in the absence of unjust enrichment, which is not true given exemplary damages, deterrence is not precluded. Taking a case similar to the present appeal, while an unscrupulous fiduciary would know that he or she would not be compelled to give up the surreptitiously obtained property if there were no gains in value to the property, he or she must also reckon with the possibility that if there *were* gains in value, and therefore unjust enrichment, he or she *would* be compelled to pay damages or possibly give up the property. Thus, if the fiduciary were motivated to breach his or her duty because of the prospect of pecuniary gains, which would, I imagine, be the typical, if not the exclusive, motive for such a breach, not ordering a constructive trust where there have been no pecuniary gains does not affect deterrence. I therefore disagree with McLachlin J. that deterrence suggests that a constructive trust should be available even where there is no unjust enrichment.

77 As is clear, I cannot agree with McLachlin J. that a constructive trust could be ordered, and indeed should have been ordered, in the present case even if there was no unjust enrichment. In order to decide whether such a remedy could be ordered, in my view, it must be decided whether there was unjust enrichment in the present case.

Was There Unjust Enrichment?

78 In my opinion, there was no enrichment and therefore no unjust enrichment in the present case. It is first of all plain that there were no pecuniary advantages accruing to the appellants from the purchase of the property. The trial judge stated (at p. 68):

> I now consider the facts of the case at bar. The nature of the duty and of the breach have already been discussed. At an interlocutory stage, the plaintiff abandoned any claim for damages. *This step involved no sacrifice because the plaintiff could not have proved any.* [Emphasis added.]

Any enrichment from the purchase of the property was not pecuniary, which would suggest that there has in fact been no enrichment and therefore no unjust enrichment.

79 It could, perhaps, be argued that if the property were unique or otherwise difficult to value, the defendant's pecuniary gains may not represent the enrichment of the defendant or the deprivation of the plaintiff. Analogizing to the award of specific performance in contract, where property that is the subject of a contract is unique or otherwise difficult to value, and the contract is breached, it may be held that monetary damages are inadequate and thus a remedy of specific performance must be ordered to compensate the plaintiff adequately. In such cases, pecuniary damages may not represent the loss to the plaintiff or the gain to the defendant from the breach. Thus, perhaps, an enrichment could be found in the absence of a change in market price if the property were unique or otherwise difficult to value.

80 Whether or not such considerations could be relevant to a finding of an enrichment, the property in question was not found to be unique or otherwise difficult to value in a manner relevant to the remedy. The trial judge noted that the respondent had asserted that the property in question had special value to him given its tenant, a bank, and the significance of being a landlord to a bank in the Greek community. The trial judge (at p. 69) held that such a factor should not be taken into account any more than personal attachment in an eminent domain case. In other words, while there may have been personal motivation for the purchase, this was not relevant to an assessment of the value of the property. This indicates, in my view, that the trial judge did not view the property to be unique in a manner meaningful to the remedial analysis. Such a conclusion is plain in the trial judge's analysis of *Lee v. Chow* (1990), 12 R.P.R. (2d) 217 (Ont. H.C.). In *Lee*, a constructive trust was declared in

a property that had been purchased surreptitiously by an agent in a situation similar to the present case. The trial judge in the instant appeal distinguished *Lee* in the following way (at p. 70):

> [The circumstances in *Lee*] included the following: a degree of dependence by the plaintiff which, in my view, is lacking in the case at bar; that it was a residential property meeting the specific requirements of the plaintiff, *rather than a commercial property having value only as an investment*; and that it appeared probable that the acquisition price represented a bargain, while the property at issue in the case at bar did not. [Emphasis added.]

In *Lee* there were pecuniary gains, thus an enrichment, and the property had unique qualities which helped justify a constructive trust. In the present case there were no pecuniary gains, and the trial judge did not find any meaningful non-pecuniary advantages associated with the property — the property had value "only as an investment". In my view, given the absence of both pecuniary and non-pecuniary advantages from the property, there was no enrichment and therefore no unjust enrichment.

81 In the absence of unjust enrichment, in my view the trial judge was correct not to order the remedy sought, a constructive trust. The trial judge stated (at p. 69):

> A constructive trust was deemed appropriate in *Lac Minerals, supra*, because damages were deemed to be unsatisfactory. It would be anomalous to declare a constructive trust, in effect, because a remedy in damages is unsatisfactory, the plaintiff having suffered none.

The trial judge, in the absence of pecuniary damages which might have indicated unjust enrichment, declined to order a constructive trust. Neither the majority of the Court of Appeal nor McLachlin J. raise an error in principle in the trial judge's reasons; indeed, in my view they err in concluding that a constructive trust is available in the present case. Even if the trial judge ignored factors such as the moral quality of the defendants' acts and deterrence, which he did not, and even if this could be construed as an error in principle, the factors to be considered in ordering a constructive trust only become relevant at the second stage of the inquiry when it is decided what remedy is appropriate. Unless unjust enrichment is made out at the first stage of the inquiry, there is no need to consider the factors relevant to ordering a constructive trust. The majority of the Court of Appeal erred in interfering with the trial judge's discretion and in deciding that a constructive trust may be ordered in the absence of unjust enrichment.

Conclusion

82 Since the trial judge did not err in not ordering a constructive trust, but rather the majority of the Court of Appeal did in ordering one, I would allow the appeal, set aside the judgment of the Court of Appeal and reinstate the judgment of the trial judge. In the circumstances, I would not award costs to the appellants either here or in the Court of Appeal.

Appeal dismissed.

Pourvoi rejeté.

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Tab 3

2009 ABCA 99
Alberta Court of Appeal

Brookfield Bridge Lending Fund Inc. v. Vanquish Oil & Gas Corp.

2009 CarswellAlta 682, 2009 ABCA 99, [2009] 7 W.W.R. 1, [2009] A.W.L.D. 2389, [2009] A.W.L.D. 2419, 177 A.C.W.S. (3d) 403, 454 A.R. 162, 5 Alta. L.R. (5th) 1

Brookfield Bridge Lending Fund Inc. (Appellant / Plaintiff) and Vanquish Oil & Gas Corporation and King Energy Inc. (Not Parties To the Appeal / Defendants) and Second Wave Petroleum Ltd. and Brookfield Bridge Lending Fund Inc. (Appellants / Purchaser and Secured Creditor) and Karl Oil and Gas Ltd. and Buffalo Resources Corp. (Respondents / Creditors)

R. Berger, F. Slatter, P. Rowbotham JJ.A.

Heard: March 11, 2009
Judgment: May 14, 2009 *
Docket: Calgary Appeal 0801-0255-AC

Proceedings: reversing *Brookfield Bridge Lending Fund Inc. v. Vanquish Oil & Gas Corp.* (2008), 2008 CarswellAlta 1349, 2008 ABQB 444, 96 Alta. L.R. (4th) 329 (Alta. Q.B.)

Counsel: H.A. Gorman, L. Mason for Appellant, Brookfield Bridge Lending Fund Inc.
W.E.B. Code, J. Lambert for Respondent, Karl Oil and Gas Ltd.
R.C. Steele for Respondent, Buffalo Resources Corp.

Subject: Estates and Trusts; Natural Resources; Contracts

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Bank of Nova Scotia v. Société Générale (Canada) (1988), 1988 CarswellAlta 288, 58 Alta. L.R. (2d) 193, [1988] 4 W.W.R. 232, 68 C.B.R. (N.S.) 1, 87 A.R. 133 (Alta. C.A.) — referred to

Barnabe v. Touhey (1995), 1995 CarswellOnt 1167, 10 E.T.R. (2d) 68, 37 C.B.R. (3d) 73, 26 O.R. (3d) 477 (Ont. C.A.) — referred to

Bassano Growers Ltd. v. Price Waterhouse Ltd. (1998), 1998 CarswellAlta 555, (sub nom. *Bassano Growers Ltd. v. Diamond S Produce Ltd. (Bankrupt))* 216 A.R. 328, (sub nom. *Bassano Growers Ltd. v. Diamond S Produce Ltd. (Bankrupt))* 175 W.A.C. 328, 66 Alta. L.R. (3d) 296, 6 C.B.R. (4th) 199, 1998 ABCA 198 (Alta. C.A.) — referred to

Elliott, Re (2002), 2002 ABQB 1122, 2002 CarswellAlta 1686, [2003] 5 W.W.R. 275, 30 C.P.C. (5th) 320, 11 Alta. L.R. (4th) 358, 333 A.R. 39 (Alta. Q.B.) — referred to

Goldcorp Exchange Ltd., Re (1994), [1995] 1 A.C. 74, [1994] 2 All E.R. 806 (New Zealand P.C.) — referred to

Hallett's Estate, Re (1880), [1874-1880] All E.R. Rep. 793, 13 Ch. D. 696 (Eng. C.A.) — referred to

Law Society of Upper Canada v. Toronto Dominion Bank (1998), 1998 CarswellOnt 4757, 42 O.R. (3d) 257, 169 D.L.R. (4th) 353, 116 O.A.C. 24, 44 B.L.R. (2d) 72 (Ont. C.A.) — referred to

Law Society of Upper Canada v. Toronto Dominion Bank (1999), 130 O.A.C. 199 (note), 250 N.R. 194 (note), [1999] 3 S.C.R. xiii (S.C.C.) — referred to

Neste Oy v. Lloyd's Bank Ltd. (1983), [1983] 2 Lloyd's Rep. 658 (Eng. C.A.) — referred to

Ontario (Director, Real Estate & Business Brokers Act) v. NRS Mississauga Inc. (2003), 2003 CarswellOnt 1239, 49 E.T.R. (2d) 256, 40 C.B.R. (4th) 127, 8 R.P.R. (4th) 13, 226 D.L.R. (4th) 361, 64 O.R. (3d) 97, (sub nom. *Director of Real Estate and Business Brokers v. NRS Mississauga Inc.)* 170 O.A.C. 259 (Ont. C.A.) — referred to

Ontario (Securities Commission) v. Greymac Credit Corp. (1986), 55 O.R. (2d) 673, 1986 CarswellOnt 158, 17 O.A.C. 88, 23 E.T.R. 81, 30 D.L.R. (4th) 1, 34 B.L.R. 29 (Ont. C.A.) — referred to

Ontario (Securities Commission) v. Greymac Credit Corp. (1988), 31 E.T.R. 1, 1988 CarswellOnt 597, 1988 CarswellOnt 964, (sub nom. *Greymac Trust Co. v. Ontario (Securities Comm.))* [1988] 2 S.C.R. 172, 52 D.L.R. (4th) 767, 29 O.A.C. 217, 87 N.R. 341, 65 O.R. (2d) 479 (S.C.C.) — referred to

Soulos v. Korkontzilas (1997), [1997] 2 S.C.R. 217, 212 N.R. 1, 1997 CarswellOnt 1490, 1997 CarswellOnt 1489, 9 R.P.R. (3d) 1, 46 C.B.R. (3d) 1, 17 E.T.R. (2d) 89, 32 O.R. (3d) 716 (headnote only), 146 D.L.R. (4th) 214, 100 O.A.C. 241 (S.C.C.) — followed

1653 Investments Ltd., Re (1981), 129 D.L.R. (3d) 582, 1981 CarswellBC 738 (B.C. S.C.) — referred to

Cases considered by *R. Berger J.A.* (dissenting):

Bank of Nova Scotia v. Société Générale (Canada) (1988), 1988 CarswellAlta 288, 58 Alta. L.R. (2d) 193, [1988] 4 W.W.R. 232, 68 C.B.R. (N.S.) 1, 87 A.R. 133 (Alta. C.A.) — referred to

Elliott, Re (2002), 2002 ABQB 1122, 2002 CarswellAlta 1686, [2003] 5 W.W.R. 275, 30 C.P.C. (5th) 320, 11 Alta. L.R. (4th) 358, 333 A.R. 39 (Alta. Q.B.) — considered

International Corona Resources Ltd. v. LAC Minerals Ltd. (1989), 44 B.L.R. 1, 35 E.T.R. 1, (sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.)* 69 O.R. (2d) 287, (sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.)* 61 D.L.R. (4th) 14, 101 N.R. 239, 36 O.A.C. 57, (sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.)* [1989] 2 S.C.R. 574, 6 R.P.R. (2d) 1, (sub nom. *LAC Minerals Ltd. v. International Corona Resources Ltd.)* 26 C.P.R. (3d) 97, 1989 CarswellOnt 126, 1989 CarswellOnt 965 (S.C.C.) — considered

Law Society of Upper Canada v. Toronto Dominion Bank (1998), 1998 CarswellOnt 4757, 42 O.R. (3d) 257, 169 D.L.R. (4th) 353, 116 O.A.C. 24, 44 B.L.R. (2d) 72 (Ont. C.A.) — considered

Law Society of Upper Canada v. Toronto Dominion Bank (1999), 130 O.A.C. 199 (note), 250 N.R. 194 (note), [1999] 3 S.C.R. xiii (S.C.C.) — referred to

Ontario (Director, Real Estate & Business Brokers Act) v. NRS Mississauga Inc. (2003), 2003 CarswellOnt 1239, 49 E.T.R. (2d) 256, 40 C.B.R. (4th) 127, 8 R.P.R. (4th) 13, 226 D.L.R. (4th) 361, 64 O.R. (3d) 97, (sub nom. *Director of Real Estate and Business Brokers v. NRS Mississauga Inc.)* 170 O.A.C. 259 (Ont. C.A.) — referred to

Sorochan v. Sorochan (1986), 1986 CarswellAlta 714, [1986] 2 S.C.R. 38, [1986] 5 W.W.R. 289, 29 D.L.R. (4th) 1, 69 N.R. 81, 46 Alta. L.R. (2d) 97, 74 A.R. 67, 23 E.T.R. 143, 2 R.F.L. (3d) 225, [1986] R.D.I. 448, [1986] R.D.F. 501, 1986 CarswellAlta 143 (S.C.C.) — referred to

Soulos v. Korkontzilas (1997), [1997] 2 S.C.R. 217, 212 N.R. 1, 1997 CarswellOnt 1490, 1997 CarswellOnt 1489, 9 R.P.R. (3d) 1, 46 C.B.R. (3d) 1, 17 E.T.R. (2d) 89, 32 O.R. (3d) 716 (headnote only), 146 D.L.R. (4th) 214, 100 O.A.C. 241 (S.C.C.) — considered

APPEAL by plaintiff from judgment reported at *Brookfield Bridge Lending Fund Inc. v. Vanquish Oil & Gas Corp.* (2008), 2008 CarswellAlta 1349, 2008 ABQB 444, 96 Alta. L.R. (4th) 329 (Alta. Q.B.), granting declaration that reserve fund belonged to one of applicants and should be held in trust pending resolution of dispute.

***F. Slatter J.A.*:**

1 The issue on this appeal is whether an express trust created by an operating agreement for an oil well gives the owners of that well a claim in priority over a secured creditor of the trustee.

Facts

2 Vanquish Oil & Gas, which is now in receivership, was the operator of a certain oil well. It was required to remit 45% of the net production revenues to the owner of that proportional interest in the well. Karl Oil and Gas Ltd. and Choice Resources Corporation (now known as Buffalo Resources Corp.) disagree on which of them owns that 45% interest. That does not, however, affect the outcome of this appeal as Karl and Choice take a common position on the issue presently before the court.

3 The 1990 Canadian Association of Petroleum Landmen Operating Procedure under which the well was operated imposed a trust on the net production revenues generated by the well, but it also permitted Vanquish to intermingle those funds with its own funds:

> 5.07 - COMMINGLING OF FUNDS - The Operator may commingle with its own funds the moneys which it receives from or for the account of the Joint-Operators pursuant to this Operating Procedure. Notwithstanding that moneys of a Joint-Operator have been commingled with the Operator's funds, the moneys of a Joint-Operator advanced or paid to the Operator, whether for the conduct of operations hereunder or as proceeds from the sale of production under this Operating Procedure, shall be deemed to be trust moneys, and shall be applied only to their intended use and shall in no way be deemed to be funds belonging to the Operator, other than in its capacity as the Joint-Operators' trustee.

All revenues received from the well were deposited into, and all expenses relating to its operation were paid out of Vanquish's general bank account at TD Canada Trust. That same account was also used to pay all of Vanquish's general expenses.

4 On March 14th, 2007 there was only $40,218 left in the general account, the lowest balance the account reached. On March 16th, 2007 a further $40,599 of revenue relating to the oil well was deposited. Further deposits not impressed with the trust were made, and at the date of receivership (March 28th, 2007) the account balance was back up to $417,913 (EKE, p. A276). It is argued that at the date of receivership Vanquish was in default of remitting as much as $320,539 to Karl or Choice.

5 The receiver eventually sold all of the assets of Vanquish on behalf of the appellant secured creditor Brookfield Bridge Lending Fund Inc. The issue is whether the trust created by the Operating Procedure attached to the sale proceeds, effectively giving Karl or Choice a proprietary claim to those funds.

6 The trial judge concluded that the issue was which of two innocent parties should bear the loss resulting from Vanquish's breach of trust: the non-operator working interest owner (i.e. Karl or Choice), or the appellant secured party? He concluded

that the appellant secured party "was in a far better position to ensure that its customer conducted its affairs in a fashion so as to honour the obligations clearly imposed upon it": *Brookfield Bridge Lending Fund Inc. v. Vanquish Oil & Gas Corp.*, 2008 ABQB 444, 96 Alta. L.R. (4th) 329 (Alta. Q.B.) at para. 53. In this way the trial judge essentially imposed the burden of Vanquish's breach of trust on the appellant.

Standard of Review

7 Whether a trust exists is a question of law, which will be reviewed for correctness. Whether a party is entitled in law to the imposition of a constructive trust is also a question of law, reviewable for correctness. To the extent that there is an element of discretion or fact-finding involved, some deference would be warranted, unless the imposition of a constructive trust was clearly unreasonable or based on an error of principle: *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217 (S.C.C.) at paras. 54-5.

Trusts and Trustees

8 Most trusts are consensual arrangements. They are created by the act of the settlor, who may also be the beneficiary. Sometimes the trustee is a party to the creation of the trust, but in any event the trustee must usually consent to act. The trust binds all those who are involved in its creation.

9 A trust, however, creates proprietary interests that may affect the rights of third parties who deal with the trust property. In some cases those third parties may not even be aware of the existence of the trust, or that the property they are dealing with is trust property. Since it would be unfair to allow the consensual act of those who created the trust to prejudice the rights of third parties, the courts of equity always studiously protected the interests of the "*bona fide* purchaser for value without notice". Whatever proprietary rights might be created by the trust will be extinguished if the trust property comes into the hands of such a third party. The effect of the *bona fide* third-party rule is that much of the risk of a breach of trust by the trustee will fall on the beneficiaries.

10 The law also recognizes "constructive trusts" which are often actually a form of equitable remedy. The imposition of a constructive trust can also create proprietary rights, which can also affect the interests of third parties. For that reason the courts will decline to impose a constructive trust where that would prejudice the interests of a *bona fide* purchaser for value without notice. As the Court noted in *Soulos v. Korkontzilas* at para. 45, one of the preconditions for imposing a constructive trust is that "There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g., the interests of intervening creditors must be protected."

11 The law imposes strict duties on trustees. It is certainly a prudent practice for a trustee to keep trust funds separate from its own funds, but in some situations (such as the present) the trustee may be expressly or impliedly authorized to commingle trust funds with other funds. The express or implied right to commingle does not however give the trustee the right to breach the trust. The Operating Procedure provided that the funds could be applied "only to their intended use". This was not the type of trust where the trustee is effectively allowed to borrow the commingled trust funds and use them for its own private purposes. Whether commingled or not, the trustee may only expend trust funds on purposes authorized by the trust. In this case it is clear that Vanquish was in breach of trust, because it spent trust funds on unauthorized things.

12 So long as there is a positive balance in the account the analysis is easy. The trust attaches to the trust account and protects the net balance from the claims of any secured creditors: *Bank of Nova Scotia v. Société Générale (Canada)*, [1988] 4 W.W.R. 232, 58 Alta. L.R. (2d) 193 (Alta. C.A.).

13 But once the trust funds are disbursed to *bona fide* third parties for value without notice, the funds are released from the trust. The beneficiaries can no longer follow the funds. The result is the same whether the funds are kept in a segregated trust account, or whether they are commingled. The only difference is that if the trust funds are commingled with non-trust funds, the trustee is generally presumed to have honest intentions, and to have spent the non-trust funds first: *Hallett's Estate, Re* (1880), 13 Ch. D. 696 (Eng. C.A.). Thus any remaining balance will be presumed to be trust funds. The claim of the beneficiaries is *prima facie* limited to the lowest intermediate balance in the account: *Ontario (Securities Commission) v. Greymac Credit Corp.* (1986), 55 O.R. (2d) 673 (Ont. C.A.) at p. 677, affirmed *Ontario (Securities Commission) v. Greymac Credit Corp.*,

[1988] 2 S.C.R. 172 (S.C.C.); *Société Générale*; *Goldcorp Exchange Ltd., Re*, [1995] 1 A.C. 74 (New Zealand P.C.) at p. 108. It follows that in this case the remaining balance in the general account at its lowest point ($40,218) was still covered by the trust. The additional trust monies that were deposited and never expended in breach of trust ($40,599) were also covered by the trust: *Neste Oy v. Lloyd's Bank Ltd.*, [1983] 2 Lloyd's Rep. 658 (Eng. C.A.) at p. 667. Karl or Choice are entitled to their proportionate share of those subsequently deposited funds.

14 After March 14th and up to the date of the receivership on March 28th, Vanquish deposited further non-trust funds into the account. Are those funds caught by the trust? On the one hand the law could assume that the trustee Vanquish merely "borrowed" the trust funds in breach of trust, and is deemed to have repaid the misappropriated trust funds by the next deposit. On the other hand the law could take the view that once the trust funds are expended, the loss falls on the beneficiary, and it is not entitled to any proprietary claim to subsequent replenishment of the fund.

15 The law is summarized in Goff & Jones, *The Law of Restitution*, 7th ed. (London: Sweet & Maxwell, 2007) at para. 2-038 with this example:

> A trustee mixes his own money with trust money; he withdraws money from the mixed fund, dissipates some of it and then deposits more money into the mixed fund. Subsequent deposits of the fiduciary into the mixed fund are not presumed to be impressed with the trusts in favour of the beneficiary. [Citing *Roscoe v. Winder*, [1915] 1 Ch. 62, 69, *per* Sargant J.; *Bishopsgate Investment Management Ltd. v. Homan*, [1995] 1 All E.R. 347, 354, *per* Dillon L.J.] Consequently if the trustee is insolvent, that part of the mixed fund, equal to the amount paid in, will normally pass to the trustee's general creditors. The beneficiary will be entitled to additions to the mixed fund only if he can prove that thereby the trustee intended to make restitution to the trust. It follows that the trust is entitled only to the lowest intermediate balance of the mixed fund. So, if the fund is wholly dissipated before any additions are made to it, the interest of the trust in the mixed fund is extinguished. Professor Scott has justified this result on the ground that "the real reason for allowing the claimant to reach the balance [of the mixed fund] is that he has an equitable interest in the mingled fund which the wrongdoer cannot destroy as long as any part of the fund remains; but there is no reason for subjecting other property of the wrongdoer to the claimant's claim any more than to the claims of other creditors merely because the money happens to be put in the same place where the claimant's money formerly was, unless the wrongdoer actually intended to make restitution to the claimant." [*Scott on Trusts* § 518.1]

Thus the further deposits to the account are not presumed to have the effect of replenishing the trust fund: *Ontario (Director, Real Estate & Business Brokers Act) v. NRS Mississauga Inc.* (2003), 64 O.R. (3d) 97, 226 D.L.R. (4th) 361 (Ont. C.A.) at para. 49; *1653 Investments Ltd., Re* (1981), 129 D.L.R. (3d) 582 (B.C. S.C.), at pp. 597-9, 32 B.C.L.R. 71.

16 If the trust funds were segregated, the outcome would be clearer. If the trustee misappropriated segregated funds, and then deposited non-trust funds into the segregated account, the intent must have been to replenish the trust account. But where the trust funds are commingled with other funds, the intent is not so clear. Since the trustee by definition is using the account for trust and non-trust purposes, the deposits might simply be made to enable further non-trust expenditures. Where the beneficiary has created the risk of this type of expenditure by allowing commingling, it should not be allowed to easily divert funds from the other creditors of the trustee. Absent a clear intention by the trustee to replenish the trust, which is not found on this record, further deposits are not attached by the express trust.

17 It is not necessary to discuss in this appeal the rules that apply when there is a shortage in a mixed trust account, as happened in *Law Society of Upper Canada v. Toronto Dominion Bank* (1998), 42 O.R. (3d) 257 (Ont. C.A.), leave to appeal denied [1999] 3 S.C.R. xiii (S.C.C.), and *Elliott, Re*, 2002 ABQB 1122, 11 Alta. L.R. (4th) 358 (Alta. Q.B.).

Constructive Trust

18 As mentioned, Vanquish was clearly in breach of trust by expending the trust funds in unauthorized ways. As such it was in breach of its fiduciary duties as trustee. While the express trust created by the Operating Procedure no longer attached to the funds, are Karl or Choice entitled to a remedial constructive trust for the clear breach of the fiduciary duty by their trustee?

In *Soulos v. Korkontzilas* at para. 45 the Court identified four conditions which were generally necessary before a court would impose a constructive trust based on wrongful conduct:

> (1) The defendant must have been under an equitable obligation, that is, an obligation of the type that courts of equity have enforced, in relation to the activities giving rise to the assets in his hands;
>
> (2) The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligation to the plaintiff;
>
> (3) The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties; and
>
> (4) There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g., the interests of intervening creditors must be protected.

The second and fourth preconditions are absent on this record.

19 There was no satisfactory evidence on this record of what, if any, specific assets Vanquish purchased with trust funds. The ability to trace the trust funds into specific assets has always been central to the imposition of a constructive trust in circumstances like this. The only evidence came from the Receiver. He deposed (EKE A190):

> 16. Vanquish wrote numerous cheques on the Main Operating Account including operating expenses, payroll, royalties, rental and other business expenses incurred by Vanquish.
>
> 17. In addition to production revenues, Vanquish also deposited into the Main Operating Account other sums including advances by Brookfield Bridge Lending Fund Inc. ("Brookfield") as its secured lender, and other sales proceeds or equity proceeds raised by Vanquish.

During cross-examination the receiver was asked about purchases of assets. He noted a deposit of $7.45 million in April 2006, which was an advance from the appellant Brookfield and clearly not the proceeds of production from this oil well. He then noted a series of large cheques shortly after this deposit which he said "I would be speculating, those are paying for capital expenditures ... it's my belief that capital items also went through this account" (EKE A295-6). The receiver did not know how the funds had actually been spent, and merely expressed the bare opinion that the amounts were large enough to be consistent with capital expenditures. He could not depose to any specific assets that were purchased with trust funds, or any specific assets that still remained in Vanquish's hands that had been purchased with trust funds, as opposed to Vanquish's own funds. There is no evidence that the account balance was reduced by these expenditures below the amount of funds needed for Vanquish to satisfy its fiduciary obligations, and it was not a breach of trust for Vanquish to spend the loan advance from Brookfield. These transactions took place about one year before the receivership. To the extent that the trial reasons involve a finding of fact respecting the tracing of the funds, they reflect palpable and overriding error.

20 It therefore cannot be shown that the trust proceeds were expended on any of Vanquish's assets that formed a part of the eventual realization by the receiver, so as to satisfy the second precondition. Since Vanquish's wrongdoing cannot be traced into any asset, that precludes the imposition of a constructive trust: *Bassano Growers Ltd. v. Price Waterhouse Ltd.*, 1998 ABCA 198, 66 Alta. L.R. (3d) 296 (Alta. C.A.) at para. 13. The trust funds were apparently used for Vanquish's general ongoing operations. As said in *NRS Mississauga Inc.* at para. 37, it is insufficient "that some unspecified amount of trust funds were used at some unspecified time in some unspecified way to assist to some unspecified degree in maintaining the operation of the business."

21 The fourth precondition in *Soulos v. Korkontzilas* is also missing. The appellant had a perfected prior secured interest. The decision under appeal essentially assumes that a secured creditor has a positive duty to monitor the fiduciary activities of its borrowers. On the assumption that the secured creditor has a "better opportunity" to prevent breaches of trust, it essentially becomes a guarantor for any such breaches of trust. This analysis discounts the fact that the underlying risk of misappropriation

was created by the respondents allowing the commingling of the trust funds, and transfers the duty of monitoring that risk to the appellant. This is contrary to the principle stated in *Soulos v. Korkontzilas* that "the interests of intervening creditors must be protected": *Barnabe v. Touhey* (1995), 26 O.R. (3d) 477 (Ont. C.A.).

22 The contention that the appellant had a better opportunity to prevent breaches of trust is, in any event, unconvincing. The respondent had agreed that its trustee could mingle the trust funds with its own funds. There was accordingly no realistic way that the appellant could challenge any expenditure from the mixed account; the fact that funds were being spent from the mixed account on non-trust purposes was not objectionable. In order to monitor the trust, the appellant would have had to keep precise records of the amount of trust money coming into the account at TD Canada Trust, and then monitor each and every expenditure from the account to determine that the balance of the account was never reduced below the net trust balance. This would require the appellant to monitor the trustee's business on a daily basis. It is unreasonable to allow the respondent to foist that duty on the appellant by operation of law.

23 The analysis in the reasons under appeal also overlooks the fact that the imposition of the constructive trust gave the respondents a priority over not only the appellant secured creditor, but also potentially the unsecured creditors of Vanquish. Even if the appellant had a "better opportunity" to prevent the breach of trust, the unsecured creditors had no such opportunity. While the unsecured creditors in particular cases may not receive anything anyway, it would be anomalous if the entitlement to a constructive trust against the secured creditor depended on whether and to what extent the unsecured creditors were affected.

24 The respondents argue that it should be assumed the appellant knew Vanquish dealt with trust funds, and so the appellant is not a party "without notice" and would not be protected in equity. This argument also overlooks the effect of the imposition of a constructive trust on the unsecured creditors. But in any event, the mere knowledge that Vanquish dealt with trust funds from time to time is not sufficient. Without knowledge that the funds it received were being paid in breach of trust or were trust assets, the appellant would not lose its protection under the rule in *Soulos v. Korkontzilas*. This is just another way of saying that the appellant had a duty to police Vanquish's management of the trust funds.

25 This appeal demonstrates the shortcomings of a practice, which is apparently an industry-wide practice, of letting oil well operators commingle trust funds with non-trust funds, while purporting to limit the ability of the operator to use those funds only for operation of the specific well. It must be remembered that it is the respondents who created the risk of these circumstances arising by agreeing that trust and non-trust money could be commingled. Where the conduct of one party creates the problem, that is a relevant consideration in deciding whether a constructive trust should be imposed: D.M. Paciocco, *The Remedial Constructive Trust: A Principled Basis for Priorities Over Creditors* (1989), 68 Can. Bar Rev. 315 at pp. 348-9. It was a reviewable error to impose a constructive trust in this situation.

Conclusion

26 In conclusion, it was an error of principle to impose a constructive trust in the circumstances of this case. The express trust agreed to by the parties only attached to the lowest balance of the account on March 14th, 2007, plus the respondents' proportion of the additional trust funds deposited on March 16th, 2007. The appeal is allowed.

***P. Rowbotham J.A.*:**

I concur.

***R. Berger J.A.* (Dissenting):**

27 I have had the advantage of reading in draft form the Reasons for Judgment of the majority. Mindful that the standard of appellate review requires deference to fact-finding, I am unable to agree that the imposition of a constructive trust in the circumstances of this case was clearly unreasonable or based on an error of principle. Two wrongful acts on the part of Vanquish Oil & Gas Corporation ("Vanquish") are made out: breach of trust and breach of fiduciary duty. The breaches occurred when Vanquish failed to remit the proportionate share of the net production revenues to the non-operator as required by s. 507 of the 1990 Canadian Association of Petroleum Landmen Operating Procedure ("CAPL Operating Procedure"). It is trite law that

an operator is in a fiduciary position with respect to receipts and revenues held on behalf of non-operators. See *Bank of Nova Scotia v. Société Générale (Canada)* (1988), 87 A.R. 133 (Alta. C.A.) ("*Sorrel*").

28 In *Sorrel*, the operator's bank sought to enforce a security interest held on the operator's bank account. The relationship between the operator and the non-operator was governed by the earlier 1981 CAPL Operating Procedure. The bank account contained excess funds advanced by the non-operators for operating expenses and production revenues. Stratton J.A. held that the 1981 CAPL Operating Procedure created a fiduciary duty and an express trust in relation to excess funds and joint operator production revenues. The funds in the operator's account were impressed with a trust in favour of Sorrel and as such Sorrel's creditors had no claim to them: at para. 19.

29 A remedial constructive trust creates property rights and provides a remedy for wrongful acts or unjust enrichment. See *International Corona Resources Ltd. v. LAC Minerals Ltd.*, [1989] 2 S.C.R. 574 (S.C.C.).

30 The leading decision on the test to impose a constructive trust to remedy a wrongful act is *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217 (S.C.C.). In *Soulos*, McLachlin J. (as she then was) recognized that a constructive trust may be imposed not only as a remedy for unjust enrichment, but to condemn wrongful acts and maintain the integrity of relationships of trust that underlie industries and institutions: at para. 14. From *Soulos* emerges a doctrine of constructive trust that may be imposed where good conscience so requires. Doing justice in the case, the Court held, prevails over simplistic factual restrictions. McLachlin J. sets out the four conditions that must be generally satisfied in order to impose a constructive trust for a wrongful act (at para. 45):

> (1) The defendant must have been under an equitable obligation, that is, an obligation of the type that courts of equity have enforced, in relation to the activities giving rise to the assets in his hands;
>
> (2) The assets in the hands of the defendant must be shown to have resulted from deemed or actual agency activities of the defendant in breach of his equitable obligation to the plaintiff;
>
> (3) The plaintiff must show a legitimate reason for seeking a proprietary remedy, either personal or related to the need to ensure that others like the defendant remain faithful to their duties; and
>
> (4) There must be no factors which would render imposition of a constructive trust unjust in all the circumstances of the case; e.g. the interests of intervening creditors must be protected.

31 The obligation created by the 1990 CAPL Operating Procedure satisfies the first condition. Section 507 of the 1990 CAPL Operating Procedure was intended to create an express trust for non-operators over excess funds advanced by the non-operators and over joint operator production revenues. Section 507 reads as follows:

> COMMINGLING OF FUNDS - The Operator may commingle with its own funds the moneys which it receives from or for the account of the Joint-Operators pursuant to this Operating Procedure. Notwithstanding that moneys of a Joint-Operator have been commingled with the Operator's funds, the moneys of a Joint- Operator advanced or paid to the Operator, whether for the conduct of operations hereunder or as proceeds from the sale of production under this Operating Procedure, shall be deemed to be trust moneys, and shall be applied only to their intended use and shall in no way be deemed to be funds belonging to the Operator, other than in its capacity as the Joint-Operators' trustee.
>
> [emphasis added]

32 The central issue in this appeal is whether the second condition precedent is met. This being a commercial context, there must be a factual connection between the constructive trust property and the breach: *Ontario (Director, Real Estate & Business Brokers Act) v. NRS Mississauga Inc.* (2003), 64 O.R. (3d) 97 (Ont. C.A.). What degree of connection is required? Does the evidence in this case satisfy that requirement? Doherty J.A. held that general connections between trust funds and accounts receivable were an insufficient basis to satisfy the *Soulos* test where the evidence only showed that trust monies were used for general business purposes. He concluded that he would not impose a constructive trust "given the absence of any *clear connection* between the misappropriation of trust funds and the accounts receivable ..." (at para. 40) [emphasis added].

33 While I agree that a "factual connection" is required, I question whether the presence or absence of a "factual" or "clear connection" - a question of fact - is reviewable on appeal. I acknowledge the admonition that it may be necessary and appropriate to scrutinize closely the contributions of business partners to the acquisition of property (per Dickson C.J. in *Sorochan v. Sorochan*, [1986] 2 S.C.R. 38 (S.C.C.) at para. 22). It does not follow, however, that something more than a factual connection (or, as Dickson C.J. put it, Asome reasonable connection) between the breach and the assets in question made out to the satisfaction of the trier of fact is required.

34 The Appellants submit that the chambers judge could only impose a constructive trust over specific, identifiable money and not over all of Vanquish's money. Were that argument to prevail, evidentiary certainty becomes determinative rather than equitable outcome. I accept the Respondents' submission that whether conceived of as institutional or remedial, the constructive trust is best understood as an equitable rectification of a situation gone wrong. It prescribes accountability on the part of certain individuals and in appropriate circumstances confers personal or proprietary rights on others when, in the discretion of the trial judge, the dictates of justice require it.

35 In the instant case, the evidence before the chambers judge concerned, in part, the nature and source of the Vanquish assets that were to be distributed as a result of the receivership. The cross-examination of the Receiver on his affidavit disclosed:

> (a) that all of Vanquish's revenues, including production revenues from Simonette, went into one bank account and all of its expenses were paid from that same bank account.
>
> (Key Evidence, Vol. 2, A291/3-13)
>
> (b) The Receiver confirmed that Vanquish received 100% of the production revenues from the Simonette Well but never paid out any money to the holder of the 45% interest (either Karl or Choice Resources Corporation).
>
> (Key Evidence, Vol. 2, A300/9-A301/14)
>
> (c) in addition to paying ordinary operating expenses, the Receiver believed, based upon his review of Vanquish's bank account information, that Vanquish used large amounts of its production revenues to purchase other assets. The Receiver did not know for sure what Vanquish had actually purchased, but he was reasonably certain, by reference to a single month only from the relevant period (April 2006), that Vanquish was using moneys paid into its bank account to pay capital expenditures or buy assets.
>
> (Key Evidence, Vol. 2, A294/22-A296/15)
>
> (d) the bank statement for April 2006 references the following amounts, which the Receiver thought were sizeable enough that they probably represented payments for the purchase of assets (Key Evidence, Vol. 2, Affidavit of Receiver A211-216):
>
> > $330,712; $495,009; $287,123; $346,737; $253,337; $188,188; $207,960; $133,822; $300,000; $389,972; $2,244,267; $285,266; $254,716; $131,821; $136,948; $129,234; $2,000,080; $111,860.
>
> The cross-examination in respect of some of those payments is set out at Key Evidence, Vol. 2, A296/11-25.
>
> (e) All of the assets purchased by the payments of cash out of Vanquish's bank account, including (as a partial subset only) those listed above, were then sold by the Receiver and the proceeds received.
>
> (Key Evidence, Vol. 2, A299/19-27)
>
> (f) From the proceeds of the sale of those assets, the reserve fund was created. The Receiver agreed that, but for the sale of all of Vanquish's assets, there would not be a reserve fund.
>
> (Key Evidence, Vol. 2, A300/1-8)

36 I accept the Respondents' submission that strict adherence to the evidentiary underpinning of the timing and source of various deposits and withdrawals, and a strict view of the proprietary nature of the beneficiary's claim, often neglect both the equities and the realities of the situation before the Court. That is precisely the remedial problem that the decision of the Supreme Court of Canada in *Soulos* corrects. See also *Elliott, Re* (2002), 11 Alta. L.R. (4th) 358 (Alta. Q.B.) and *Law Society of Upper Canada v. Toronto Dominion Bank* (1998), 42 O.R. (3d) 257 (Ont. C.A.), leave to appeal dismissed (1999), 130 O.A.C. 199 (note) (S.C.C.).

37 In *Elliott, Re*, Sulatycky A.C.J. (as he then was) preferred the most just result rather than a mathematical or mechanistic approach. He selected a remedy which he found in all of the circumstances to be "the most just, convenient equitable and workable" (at p. 370). In his opinion, the case law conferred upon him a discretion to choose the most equitable solution.

38 Similarly, in *Law Society of Upper Canada*, the Ontario Court of Appeal, having analysed the competing approaches previously employed in the historical jurisprudence, observed (at p. 269):

> ... There seems to be no binding authority compelling the application of one approach or the other to circumstances such as those in this case. The court should therefore seek to apply the method which is the more just, convenient and equitable in the circumstances.

39 The Ontario Court of Appeal added that, on the appropriate facts, a number of remedies are available, including the constructive trust (at p. 273):

> It is noteworthy that both the 'fund as amalgam' and the 'fund as a blend' approaches enable equity to offer the remedy of a charge, lien or constructive trust *vis-à-vis* the remaining balance in the fund. The former has the effect, however, of limiting the reach of these proprietary remedies. To my mind such a restriction is not necessary. While 'proprietary tracing' may serve as the equitable vehicle which enables a claimant to have recourse to a mixed trust fund in the first place, equity can move beyond the strictures of that doctrine to provide a remedy to the claimant once the connection to the fund has been made. The nexus is to be found in the concept of the equitable charge, lien or constructive trust. These concepts need not, in my view, be confined to any part of the fund because, by their very nature, they have always been applied against *the whole* of the fund.
>
> [emphasis in original]

40 In *International Corona Resources Ltd. v. LAC Minerals Ltd.*, *supra*, La Forest J. rejected the arbitrary notion that the absence of an identifiable property right precluded the imposition of a constructive trust. The Court held that the remedy could be used to create a property right in the defendant's property. La Forest J. said (at para. 194):

> Secondly, it is not the case that a constructive trust should be reserved for situations where a right of property is recognized. That would limit the constructive trust to its institutional function, and deny to it the status of a remedy, its more important role. Thus, it is not in all cases that a pre-existing right of property will exist when a constructive trust is ordered. The imposition of a constructive trust can both recognize and create a right of property. When a constructive trust is imposed as a result of successfully tracing a plaintiff's asset into another asset, it is indeed debatable which the Court is doing. Goff and Jones, The Law of Restitution (3rd ed. 1986), at p. 78, take the position that:
>
> > ... the question whether a restitutionary proprietary claim should be granted should depend on whether it is just, in the particular circumstances of the case, to impose a constructive trust on, or an equitable lien over, particular assets, or to allow subrogation to a lien over such assets.
> >
> > It is the nature of the plaintiff's claim itself which is critical in determining whether a restitutionary proprietary claim should be granted; the extent of that claim is a different matter, which should be dependent upon the defendant's knowledge of the true facts. ...

41 On the facts of this case, I agree with the Respondents' contention that a "dead end" tracing rule does not provide an appropriate, just or equitable remedy for the breach of trust suffered by Karl or Choice. On this record there was ample evidence to support the chambers judge's conclusion that Vanquish's "blatant breach of trust" (A.B. Digest, F30, para. 45) was sufficient "to engage the conscience of this Court in support of finding a constructive trust ..." (A.B. Digest, F31, para. 55).

42 I agree with my colleagues that the third pre-condition is satisfied on this record.

43 As to the fourth condition, the Appellant contends that "Brookfield did not participate in any wrongdoing and cannot be classified as a 'wrongdoer' who will benefit from their wrongful acts if a constructive trust is not imposed. Brookfield was not contacted by Choice or Karl prior to the receivership to inform them that they had a trust claim and the amounts should be segregated." (A.B. Digest, F30, para. 47)

44 The chambers judge appreciated that he had to decide which of the two innocent parties (i.e. Vanquish's secured lender on the one hand, or the non-operator working interest owner on the other) should bear the loss of Vanquish's breach of trust. He was alive to the Appellant's argument that it is an innocent, *bona fide* purchaser for value. But Brookfield is not a *bona fide* purchaser for value *without notice*. It is not, in my view, the type of third party to whom equity provides exceptions. Brookfield is a sophisticated entity. Although it is not party to CAPL Operating Procedure Clause 507, the chambers judge would most surely have understood that, in the exercise of Brookfield's due diligence, Brookfield would have knowledge of Clause 507 and would have been aware that it governed the operations of the Simonette Well and was the basis of the trust relationship with the non-operator. That is not denied. With the foregoing in mind, he reasoned as follows:

> "... [W]hat is key here in my view is that Vanquish's secured lender was in a far better position to ensure that its customer conducted its affairs in a fashion so as to honour the obligations clearly imposed upon it by the 1990 CAPL Operating Procedure in general, and in particular Section 507 thereof. As matters presently stand, Vanquish's secured lender has arguably benefited from Vanquish's breach of trust in that had the production revenues remained in the Main Operating Account as at the date of the receivership, then based upon the authority in ***Société Générale***, those funds would clearly have belonged to the non-operator working interest owner and not the secured creditor." (A.B. Digest, F31, para. 53)

45 The chambers judge was seized with the Vanquish Receivership from the beginning. He was intimately familiar with the factual underpinnings and the content of the Court file. His impugned conclusions, in my opinion, are premised upon unassailable findings of fact which informed his exercise of discretion and which are entitled to deference on the palpable and overriding error standard. Having properly instructed himself on the law, having dutifully assessed and weighed the evidence, and having exercised his discretion reasonably and without reliance on erroneous principle, the appeal must be dismissed.

Appeal allowed.

Footnotes

* A corrigendum issued by the Court on June 23, 2009 has been incorporated herein.

Tab 4

2005 ABQB 35
Alberta Court of Queen's Bench

Grant v. Ste. Marie

2005 CarswellAlta 71, 2005 ABQB 35, [2005] 5 W.W.R. 187, [2005] A.W.L.D. 1323, [2005] A.W.L.D. 1355, [2005] W.D.F.L. 1633, 375 A.R. 33, 39 Alta. L.R. (4th) 71, 8 C.B.R. (5th) 81

Daniel Grant (Plaintiff) and Paul Noel Ste. Marie and the Trustee for the Estate of Paul Noel Ste. Marie a Bankrupt and J. André Ouellette and Unknown Defendants Identified as A., B., and C. (Defendants)

Slatter J.

Heard: November 25, 2004
Judgment: January 18, 2005
Docket: Calgary 0201-21463

Counsel: B.G. Schumacher for Plaintiff
C.J. Shaw, Q.C. for Trustee in Bankruptcy

Subject: Estates and Trusts; Insolvency; Family; Property

Table of Authorities

Cases considered by *Slatter J.*:

Boscawen v. Bajwa (1995), [1995] 4 All E.R. 769, [1996] 1 W.L.R. 328 (Eng. C.A.) — referred to

Clayton's Case, Re (1816), 35 E.R. 781, 1 Mer. 572, [1814-23] All E.R. Rep. 1 (Eng. Ch. Div.) — referred to

Cohen v. Mahlin (1926), 8 C.B.R. 23, [1927] 1 W.W.R. 162, 22 Alta. L.R. 487, [1927] 1 D.L.R. 577, 1926 CarswellAlta 45 (Alta. C.A.) — referred to

Foskett v. McKeown (2000), [2001] 1 A.C. 102, [2000] 3 All E.R. 97 (U.K. H.L.) — considered

Hallett's Estate, Re (1880), 13 Ch. D. 696 (Eng. Ch. Div.) — referred to

Kern Agencies Ltd. (No. 3), Re (1932), 13 C.B.R. 333, [1932] 1 W.W.R. 585, 1932 CarswellSask 2 (Sask. K.B.) — referred to

Nakashidze, Re (1948), 29 C.B.R. 35, [1948] O.R. 254, [1948] 2 D.L.R. 522, 1948 CarswellOnt 98 (Ont. H.C.) — referred to

Ontario (Securities Commission) v. Greymac Credit Corp. (1988), 31 E.T.R. 1, (sub nom. *Greymac Trust Co. v. Ontario (Securities Comm.))* [1988] 2 S.C.R. 172, 52 D.L.R. (4th) 767, 29 O.A.C. 217, 87 N.R. 341, 65 O.R. (2d) 479, 1988 CarswellOnt 597, 1988 CarswellOnt 964 (S.C.C.) — referred to

Ridout Real Estate Ltd., Re (1957), 36 C.B.R. 111, 1957 CarswellOnt 34 (Ont. S.C.) — referred to

Selangor United Rubber Estates Ltd. v. Cradock (1968), [1968] 2 All E.R. 1073, [1968] 2 Lloyd's Rep. 289, [1968] 1 W.L.R. 1555 (Eng. Ch. Div.) — referred to

Soulos v. Korkontzilas (1997), 212 N.R. 1, 1997 CarswellOnt 1489, 9 R.P.R. (3d) 1, 46 C.B.R. (3d) 1, 32 O.R. (3d) 716 (headnote only), 146 D.L.R. (4th) 214, 100 O.A.C. 241, 17 E.T.R. (2d) 89, [1997] 2 S.C.R. 217, 1997 CarswellOnt 1490 (S.C.C.) — followed

Ste. Marie, Re (2001), 2001 ABQB 374, 2001 CarswellAlta 617, 25 C.B.R. (4th) 110, 287 A.R. 375 (Alta. Q.B.) — referred to

Thomson v. Clydesdale Bank (1893), [1893] A.C. 282 (U.K. H.L.) — referred to

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
s. 67(1)(a) — referred to

s. 121(1) — referred to

Currency Act, R.S.C. 1985, c. C-52
Generally — referred to

ACTION by beneficiary of trust for return of funds held by trustee's trustee in bankruptcy.

***Slatter J.*:**

1 The issue on this summary trial is whether the Plaintiff, who was defrauded by the bankrupt Defendant, can trace certain funds that he paid to the Bankrupt into the hands of the Trustee in Bankruptcy.

Facts

2 In the early 1990s the Bankrupt defrauded approximately seven people, including members of his family. He had other debts at the time, and he was petitioned into bankruptcy on July 4, 1994. Some of his fraudulent acts predated the date of bankruptcy, and some of them postdated the date of bankruptcy. The Bankrupt's application for discharge was refused, and he has remained an undischarged bankrupt from 1994 to the present date.

3 The Bankrupt was criminally charged because of his activities, and in 2001 he pled guilty to seven counts of fraud. The total amount involved was $328,000.00. In anticipation of his guilty plea, and in order to reduce the sentence that might be imposed on him, the Bankrupt attempted to make restitution to some of his victims. In order to do so, he fraudulently induced the Plaintiff to pay him certain funds which are the subject of this litigation.

4 The Plaintiff is a businessman with interests in Central Alberta. In 2001 he wished to expand his business, but was in need of financing. His attempts to raise funds from conventional sources had failed. Some of his business associates introduced him to the Bankrupt as a possible source of funds. When the Plaintiff and the Bankrupt met, the Bankrupt held himself out to be a wealthy man with many assets and many business interests. The Bankrupt represented to the Plaintiff that he could raise $10 million in funding through the Bankrupt's cousin in Montreal. However, in order to raise the funds he would require a fee of $250,000.00 to be paid to his cousin. After some negotiation the Bankrupt reduced the agreed fee to $195,000.00.

5 The Plaintiff then reached an agreement with the Bankrupt that the fee would be paid in advance, but that it would not be released until the promised financing was in place. The Bankrupt agreed to hold the funds in trust, and only to release them

to his cousin when the funding was advanced. If the funding was never forthcoming, then the funds were to be returned to the Plaintiff. An unusual feature of the arrangement was that the fee was to be paid in cash. The arrangement was accordingly that the Plaintiff would deliver $195,000.00 in Canadian currency to the Bankrupt. The Bankrupt was to hold that large bundle of currency until the promised financing was advanced. If the financing was advanced, the cash fee would be paid to the cousin in Montreal. If the funding never materialized, then the Bankrupt was to deliver the "very same bills" back to the Plaintiff.

6 The Plaintiff did not have all the funds readily available. As his business generated cash, he advanced funds (in $20, $50 and $100 bills) to the Bankrupt between December of 2000 and March of 2001.

7 Needless to say, the Bankrupt never arranged any financing, and he did not hold the currency in trust. Rather, he paid the funds received from the Plaintiff to Mr. J. A. Ouellette, the counsel representing him on his criminal charges. Counsel placed the funds in his trust account, used part of it to pay legal fees, and on February 20, 2001 paid into Court the sum of $168,294.00. These funds were offered as partial restitution for the victims of the previous frauds. Before the money could be distributed to the victims, the bankruptcy came to light, and in October of 2001 the Honourable Justice C.A. Kent ordered that costs of various parties be paid from the funds, and that the balance of the funds be paid to the Trustee in Bankruptcy: *Ste. Marie, Re*, 2001 ABQB 374, 287 A.R. 375, 25 C.B.R. (4th) 110 (Alta. Q.B.). The interest of the Plaintiff in the funds was not known at this time.

8 The exact timing of the payments is of importance. The Trustee prepared an analysis of the payments from the Plaintiff to the Bankrupt, and from the Bankrupt to his counsel:

Date	**Funds paid to Ste. Marie by Grant**	**Funds paid to Ouellette by Ste. Marie**	**Balance**
December 1/00	90,000.00		90,000.00
December 4/00	25,000.00		115,000.00
December 4/00		40,000.00	75,000.00
December 5/00		9,000.00	66,000.00
December 5/00		1,000.00	65,000.00
January 8/01	60,000.00		125,000.00
February 16/01		140,000.00	(15,000.00)
	175,000.00	190,000.00	
Mr. Ouellette's accounts		21,706.00	
February 20/01	**Funds paid into Court by Mr. Ouellette**	168,294.00	
March 9/01	20,000.00		
Total Funds paid to Ste. Marie by Grant	195,000.00		

The contents of this table were agreed to by the parties. The cash paid by the Plaintiff to the Bankrupt on March 9, 2001 was never paid to Mr. Ouellette, and has disappeared. Those funds are not at issue in this case.

9 It will be noted that there is no perfect chain of payment from the Plaintiff to the Bankrupt and then to his counsel. There are temporal gaps in the payments, and the amounts do not always match. For example, by December 4 th the Plaintiff had paid the Bankrupt $115,000,00, but only $40,000.00 had been paid into counsel's trust account. By February 16, 2001, the Bankrupt had received only $175,000.00 from the Plaintiff, but he had paid $190,000.00 to his counsel. This discloses that he had other sources of funds at the time. Nevertheless, on a balance of probabilities I am satisfied that the currency paid by the Plaintiff to the Bankrupt is in part the same currency that was paid to Mr. Ouellette.

10 An examination of the trust accounts of Mr. Ouellette shows the deposit into his trust account of large amounts of Canadian currently at the times in question. The trust ledgers show other payments of cash into the trust account prior to the first advance from the Plaintiff. For example, in May of 1999 the Bankrupt paid his counsel $3,500.00 in cash by way of retainer. On July 28, 1999 he paid a further $10,000.00 by way of cash retainer.

11 The Trustee received $165,854.70 from the Clerk of the Court on May 24, 2001. The Trustee did not receive notice of the Plaintiff's claim until September 4, 2002, about 15 months later. In the interim the Trustee had used $8,576.70 to pay legal fees, $5,598.20 to pay trustee's fees, and $500.32 to pay other expenses. It is not clear from the record whether these fees and expenses related solely to the Bankrupt's dealings with the Plaintiff's funds, or to the general administration of the estate. It is also not clear what other funds the Trustee had in hand during this time.

12 On December 20, 2002, Master Waller gave the Plaintiff leave to commence this action to determine his rights to the money.

13 In the circumstances of this case the creditors in the bankruptcy potentially stand to receive a dividend based on the fraudulent conduct of the Bankrupt, and on his ability to obtain further funds from the Plaintiff. On the other hand, if the Plaintiff is able to trace the funds into the hands of the Trustee, he will receive partial repayment of his debt, something which the other victims of the Bankrupt will not be able to achieve. In either event, the Plaintiff and the other post-bankruptcy victims are not creditors of this bankruptcy, and they are not entitled to share in any funds recovered by the Trustee: *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, s. 121(1).

The Trust

14 The summary trial proceeded largely on affidavits filed by the various parties. In addition, the Plaintiff testified. His evidence was that he had an express agreement with the Bankrupt that the currency paid to the Bankrupt would be held *in specie*, and the very same currency would be delivered back to him if the financing did not materialize. He testified that the Bankrupt specifically used the word "trust" in describing the relationship. This evidence was corroborated by the affidavit of Gilbert Likeness, who was present during these discussions.

15 The Trustee in Bankruptcy explored whether this truly was a trust relationship. The Trustee noted that some of the correspondence speaks of a "fee" for services, of "investments", and of "repayment" by the Bankrupt, terminology which is perhaps inconsistent with a trust. The Trustee also noted that the receipts given by the Bankrupt do not mention a trust at all. Having heard the Plaintiff testify, I am satisfied that words of trust were used by the Bankrupt. The Bankrupt was, as the Plaintiff pointed out, very smooth and convincing. I am satisfied that the Bankrupt was using words of reassurance, such as "trust" and "guarantee", to reassure the Plaintiff. I am accordingly satisfied that an express trust was intended by the Plaintiff.

16 In all of the circumstances, the requirements for an express trust are met. There is certainty of the subject matter, namely the bundles of currency given to the Bankrupt. There is certainty of intention, because it was the express intention of the parties that a trust be created. There is also certainty of objects: the funds would be paid to the cousin if the financing was produced, and if not they would be paid back to the Plaintiff.

17 In any event, on the circumstances of this case the Court would likely impose a remedial constructive trust. In *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217 (S.C.C.) at para. 45 the Court set out four conditions for a constructive trust where funds have been misappropriated, all of which are met here:

(a) The Bankrupt, as an agent at least, was under an equitable obligation;

(b) The funds in question resulted from a breach of that obligation;

(c) The plaintiff has a legitimate need for a proprietary remedy, due to the bankruptcy;

(d) The imposition of a trust is not inequitable.

The last requirement is perhaps the most difficult, as equity is often in the eye of the beholder. A constructive trust in a bankruptcy may give one claimant a priority over others. The importance of a trust is obviously that it gives the claimant a proprietary remedy, which is especially of importance when the defendant is insolvent: D.M. Paciocco, "*The Remedial Constructive Trust: A Principled Basis for Priorities Over Creditors*" (1989), 68 Can. Bar Rev. 315, at pg. 321. In many cases a plaintiff with

a merely personal claim will recover nothing, whereas a plaintiff with a proprietary claim will be able to recover specific identifiable assets. As Paciocco states at pg. 322:

> Concern has been expressed by a number of authors that this result is not always justified. It violates the basic policy that "insolvency should create equality in creditors", that "property . . . in liquidation should be applied in satisfaction of its liabilities *pari passu*". This policy has such appeal that it has been speculated that, had statutory regimes not been created to implement it, equity would have developed rules relating to the equal distribution of assets. It seems that the force of this policy focuses the burden of persuasion squarely on those who would give priority to remedial constructive trust beneficiaries. (footnotes omitted)
>
> (footnotes omitted)

In this case the "equities" are that the general creditors of the estate have no legitimate claim to be paid as a result of the fraudulent conduct of the Bankrupt. There will never be any "equality in creditors" in this case, because the Plaintiff does not have a claim provable in the bankruptcy. The funds of the Plaintiff and the general creditors were never intermingled. In this case the facts justify tracing and the resulting proprietary remedy.

Tracing

18 Tracing is a process that developed in parallel forms at common law and in equity. In legal terminology "following" is the exercise of locating a tangible thing that belongs to the plaintiff, while "tracing" is the process of identifying the substitute for the original thing claimed by the plaintiff: *Foskett v. McKeown*, [2000] 3 All E.R. 97 (U.K. H.L.), at pg. 119. In this case the bundles of currency would be "followed" from the Plaintiff to the Bankrupt, and then to Mr. Ouellette. Once Mr. Ouellette deposited the cash into his trust account, the funds would then be "traced" into that trust account, and then to the Clerk of the Court, and finally to the Trustee in Bankruptcy.

19 The House of Lords suggested in *Foskett v. McKeown*, at pg. 121, that the common law and equitable tracing rules can now be combined. Since it has been 130 years since the courts of equity and the common law courts were merged, this is not a surprising suggestion. In *The Law of Tracing* (Oxford: Clarendon Press, 1997) at pg. 120, L.D. Smith argues that in any event an equitable duty is not required to trace in equity. However, in this case the funds in question were clearly the subject of a trust, and it is sufficient to examine the situation on that basis.

20 To allow tracing, the value that the plaintiff gave to the defendant must be identified in the asset that is now claimed. In this case the value that the Plaintiff gave to the Bankrupt was the bundles of currency. That value can be followed and identified as far as Mr. Ouellette. When Mr. Ouellette deposited the funds into his trust account, the form of the value changed, but the value can still be identified in Mr. Ouellette's trust account, and that is sufficient to allow tracing: L.D. Smith, *The Law of Tracing* at pp. 119, 211. The requirement of identifiable value is met in this case.

21 At common law the right to trace was often lost once the property being followed was mixed with other property. In equity, the mixing of the traced property was not always fatal. In this case there are several kinds of mixing. It seems clear that the Bankrupt mixed the Plaintiff's funds with other funds. This can be seen from the fact that by February 16, 2001 the Plaintiff had paid the Bankrupt only $175,000.00, yet the Bankrupt had paid $190,000.00 into Mr. Ouellette's trust account. The Bankrupt had obviously obtained $15,000.00 from another source, which he had mixed with the Plaintiff's funds. The money was then placed into Mr. Ouellette's trust account, which was undoubtedly a mixed trust account containing trust funds belonging to many other persons. The funds were then paid to the Clerk of the Court, who also maintains a mixed trust account. Finally, the funds were paid to the Trustee in Bankruptcy, where they were mixed with other funds being held by the Trustee.

22 It should be noted that this is not the type of case where numerous beneficiaries place money into a mixed trust account, and there is subsequently a shortage in that trust account. In mixed trust fund cases where there is a shortage, the rule in *Clayton's Case, Re* (1816), 1 Mer. 572, 35 E.R. 781 (Eng. Ch. Div.) has been found to be wanting, and the courts have favoured a *pro rata* distribution of the funds: *Ontario (Securities Commission) v. Greymac Credit Corp.*, [1988] 2 S.C.R. 172 (S.C.C.). There was never any "shortage" in Mr. Ouellette's trust account, or in the accounts of the Clerk of the Court. None of the previous

fraud victims gave Mr. Ouellette funds which were mixed with the funds that were obtained from the Plaintiff, so the mixed fund rules do not apply here.

23 In my view the passage of the funds from the Bankrupt, to his counsel, to the Clerk of the Court, and then to the Trustee in Bankruptcy does not change the outcome of this case. None of those intervening holders asserted any legal ownership of the funds. This is not a case where the funds came into the hands of a stranger to the trust or a *bona fide* purchaser for value without notice. Mr. Ouellette held the funds in trust for his client (the Bankrupt), and apart from the portion he used to pay his fees he asserted no legal ownership. Likewise, the Clerk of the Court was merely a stakeholder, and asserted no interest in the funds. The Trustee in Bankruptcy of course holds all assets of the Bankrupt for the benefit of all the creditors, but the Trustee has no greater claim to the assets than the Bankrupt would have had. Trust property is not divisible among the creditors of the bankrupt: *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3, s. 67(1)(a). Accordingly, the case should be decided on the same basis as if the Bankrupt had simply deposited the currency into a bank account in his own name.

24 Despite the movement of the currency, the value it represents was always identifiable. Thus the fact that the Bankrupt mixed the Plaintiff's funds with other funds is not fatal to the Plaintiff's claim. Furthermore, the mere payment of the money into the various bank accounts is not sufficient to block the tracing: *Selangor United Rubber Estates Ltd. v. Cradock*, [1968] 1 W.L.R. 1555 (Eng. Ch. Div.) at pg. 1615; Lord Goff & G. Jones, *The Law of Restitution* (6th ed.) (London: Sweet & Maxwell, 2002) at pg. 106. Since the Plaintiff can trace his property into the hands of the Trustee, and there are no intervening *bona fide* purchasers (subject to the issue of the Trustee's fees, discussed *infra*, paras. 30-31), the Plaintiff is entitled to a proprietary remedy: *Boscawen v. Bajwa* (1995), [1996] 1 W.L.R. 328 (Eng. C.A.), at pg. 334.

Currency

25 Special problems arise when an attempt is made to trace money. Currency was originally issued by banks, and bills in circulation were bills of exchange, payable on demand to the bearer, without endorsement. The *Currency Act*, R.S.C. 1985, c. C-52, describes Bank of Canada bills as "legal tender", and now provides that they are not bills of exchange but rather a *sui generis* statutory chose in action. Whatever the characterization of Canadian currency, it must be no less negotiable than were bearer bills of exchange previously issued by a chartered bank. Anyone who came into possession of such a bill would be a holder in due course, free from most claims that could be raised by any previous holder of the bill.

26 From equity's perspective, and at common law, a person who obtains money would almost always get a good title: D. Fox, *"Bona Fide Purchase and the Currency of Money"* (1996), 55 Cambridge L.J. 547. Commercial reality could not accommodate any questions about the title to bills and coins. This would apply even if the prior owner of the currency had recorded the serial numbers, and could tell exactly which bills were wrongfully taken from him. Money can and must be so highly negotiable that a subsequent *bona fide* holder takes a good title regardless of the ability of the previous owner to trace the currency. The equitable concept of a *bona fide* purchaser for value without notice is well known. While the common law would usually enforce the legal title, there was an exception for negotiable instruments. As Smith (*supra*, para. 19) says at pg. 387:

> In contrast, the common law does not recognize any general defence of bona fide purchase for value. Pre-existing legal proprietary rights are not lost by a subsequent transfer unless the holder of the rights so intends, even if the transferee is in good faith and gives value. The exception to this is the common law version of the defence of bona fide purchase for value, which operates only in respect of a particular class of assets. The asset must be one represented by a negotiable instrument. This includes all forms of money, and a range of instruments and securities which are made negotiable either by statute or mercantile usage. Where the defence is applicable, it requires that the transferee have given value in exchange for legal ownership of the instrument, in good faith and without notice of any defect in the title of the transferor. A defect in title means a proprietary right held by someone other than the transferor. When these elements are made out, the effect is similar to that of the equitable defence: the transferee takes free of any pre-existing proprietary rights, legal or equitable, of which he did not have notice. In other words, any pre-existing proprietary rights are stripped away and lost in the transaction by which the defendant acquires its legal proprietary rights.
>
> (footnotes omitted)

The common law and equitable rules were thus the same where money was involved. Once any person in the chain has a good and unimpeachable title to money, anyone who obtains title to the money from him also has a good title. Thus, it would not matter if Mr. Ouellette had taken some of the currency in payment of his fees, and transferred it to a third party after Mr. Ouellette became aware of the source of the funds. Once there is a good title to the currency anywhere in the chain of title, all subsequent holders of the currency have a good title.

27 In this case it is not alleged that Mr. Ouellette had any actual knowledge of the source of the funds, or that they were paid to him in breach of trust, despite the highly suspicious circumstances. It is therefore not necessary to consider the situation of a holder of currency with actual knowledge that the currency was obtained by crime.

Tracing and the Proprietary Remedy

28 Because of its highly negotiable nature, persons who come into possession of Canadian currency without actual notice that it has been obtained by fraud, breach of trust, or trespass should be treated as owners of the currency with an unimpeachable title. Thus when Mr. Ouellette came into possession of the currency, he was entitled to deal with it without any regard to the interests of prior holders of that currency. Therefore, he was perfectly entitled to take a portion of the money and use it to pay his fees. That portion of the money provided by the Plaintiff to the Bankrupt cannot be recovered from Mr. Ouellette. However, with respect to the balance of the funds, Mr. Ouellette never asserted any ownership or right to it. He merely held those funds in trust for the Bankrupt, and as I have indicated the funds in his trust account stand in no different position than if the Bankrupt had deposited them into an account in his own name.

29 There remains the issue of the extra $15,000.00 that the Bankrupt delivered to Mr. Ouellette by February 16, 2001. Those funds obviously could not have come from the Plaintiff. Absent any other evidence, they are presumed to belong to the Bankrupt. The Plaintiff cannot trace his money into those funds, but the Bankrupt should be presumed to spend his own funds prior to spending the trust funds: *Hallett's Estate, Re* (1880), 13 Ch. D. 696 (Eng. Ch. Div.) at pp. 727-8. Therefore, the funds Mr. Ouellette took on February 20, 2001 to pay his accounts should *prima facie* come from the extra $15,000.00. Value was given for the extra $6,706.00 taken by Mr. Ouellette for fees, and the Plaintiff has no claim to them now. The same applies to the funds used to pay the costs ordered by Justice Kent, as those funds were paid before anyone had notice of the Plaintiff's claim.

30 Some of the funds were used by the Trustee to pay expenses before receiving notice of the Plaintiff's claim. To the extent the expenses relate to dealings with the traced funds, the Trustee is entitled to deduct them. This would include all bond fees on these funds whether they were incurred before or after notice of the Plaintiff's claim was received. Trustees were allowed fees for dealing with and preserving trust assets in *Nakashidze, Re* (1948), 29 C.B.R. 35 (Ont. H.C.); *Ridout Real Estate Ltd., Re* (1957), 36 C.B.R. 111 (Ont. S.C.); and *Kern Agencies Ltd. (No. 3), Re* (1932), 13 C.B.R. 333 (Sask. K.B.). But for the Trustee's intervention before Justice Kent, the funds might well have been paid to the other fraud victims, and would possibly have been lost. At the time the Trustee did not know these were trust funds, and not assets of the estate, and having dealt with them in good faith the estate should not have to bear these expenses.

31 Fees and expenses relating to the general administration of the estate were a legitimate expense of the estate. The estate has essentially (unknowingly) used trust funds to pay those expenses. Where the funds being traced are used to discharge a debt owed to the person who receives the traced funds, that is considered a giving of value and no tracing to the recipient is permitted. As Paciocco (*supra*, para. 17) says at pg. 321:

> If the trust property is used by the constructive trustee for the payment of his debts before the beneficiary can realize upon it, however, the beneficiary's interest may be defeated. This is because creditors who in good faith and without notice of the trust accept trust property in satisfaction of their debts are *bona fide* purchasers for value without notice.

Thus if the Bankrupt had used some of the Plaintiff's funds to pay his credit card bill, the Plaintiff could not trace his funds to the credit card company: *Cohen v. Mahlin* (1926), 22 Alta. L.R. 487 (Alta. C.A.); *Thomson v. Clydesdale Bank*, [1893] A.C. 282 (U.K. H.L.). The payment by the Trustee of legal bills owed by the estate in principle falls into the same category. The payment of the Trustee's own fees is not so clear-cut, as in one sense there is a unity between the Bankrupt and the Trustee. But

the Trustee is an officer of the Court, and a necessary part of the bankruptcy regime, and the discharge of the estate's obligation to pay the Trustee should also be considered as the giving of value. Before receiving notice of the Plaintiff's claim the Trustee was a *bona fide* purchaser for value without notice, and the Plaintiff cannot recover the portion of funds used to discharge the legitimate expenses of the estate. After the Trustee received notice of the claim, the Trustee is no longer "without notice" with respect to the balance it still held in trust, and so cannot make further use of the funds.

Conclusion

32 In conclusion, the Plaintiff is able to trace the funds he paid to the Bankrupt into the hands of the Trustee. The funds that remain never passed into the hands of a *bona fide* purchaser for value without notice. Trust funds are not property of the bankruptcy, and the Plaintiff is entitled to a proprietary remedy. The Plaintiff is entitled to judgment against the Trustee for the net funds received by the Trustee ($165,854.70), less expenses paid prior to notice of the claim on September 4, 2002 and bond fees ($15,675.22), plus any interest earned by the Trustee on those net funds. If there are any accounting issues the parties may contact me.

33 The parties may, within 30 days of these Reasons, make arrangements to speak to costs, failing which costs will follow the event.

Action allowed in part.

End of Document

Tab 5

2012 ONSC 163
Ontario Superior Court of Justice [Commercial List]

Callidus Capital Corp. v. Carcap Inc.

2012 CarswellOnt 480, 2012 ONSC 163, 211 A.C.W.S. (3d) 861, 84 C.B.R. (5th) 300

Callidus Capital Corporation (Applicant / Respondent by cross-application) and Carcap Inc. and Car Equity Loans Corp. (Respondents / Applicants by cross-application)

Application under Section 243(1) of the Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3 and Section 101 of the Courts of Justice Act, R.S.O. 1990 c. C.43

Kaptor Financial Inc. and Carcap Auto Financing (Applicants by cross-application) and Callidus Capital Corporation (Respondent by cross-application)

Mesbur J.

Heard: December 14, 2011
Judgment: January 5, 2012
Docket: CV-11-00009498-OOCL

Counsel: Harvey G. Chaiton, George Benchetrit for Applicant / Respondent by cross-application
Mel Solmon, Fred Tayar, Colby Linthwaite for Respondents and applicants by cross-application
Robb English for Toronto Dominion Bank
A. Kaufman for Proposed Receiver, BDO Canada Ltd.
Jennifer Imrie for Third Eye Capital

Subject: Corporate and Commercial; Insolvency; Civil Practice and Procedure

Table of Authorities

Cases considered by *Mesbur J.*:

Bank of Montreal v. Carnival National Leasing Ltd. (2011), 74 C.B.R. (5th) 300, 2011 ONSC 1007, 2011 CarswellOnt 896 (Ont. S.C.J.) — referred to

Bank of Nova Scotia v. Freure Village on Clair Creek (1996), 1996 CarswellOnt 2328, 40 C.B.R. (3d) 274 (Ont. Gen. Div. [Commercial List]) — followed

GE Commercial Distribution Finance Canada v. Sandy Cove Marine Co. (2011), 81 C.B.R. (5th) 47, 2011 ONSC 3851, 2011 CarswellOnt 5743 (Ont. S.C.J.) — referred to

Inducon Development Corp., Re (1991), 8 C.B.R. (3d) 306, 1991 CarswellOnt 219 (Ont. Gen. Div.) — considered

Marine Drive Properties Ltd., Re (2009), 2009 BCSC 145, 2009 CarswellBC 285, 52 C.B.R. (5th) 47 (B.C. S.C.) — considered

Swiss Bank Corp. (Canada) v. Odyssey Industries Inc. (1995), 30 C.B.R. (3d) 49, 1995 CarswellOnt 39 (Ont. Gen. Div. [Commercial List]) — referred to

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3
Generally — referred to

s. 47 — referred to

s. 244 — referred to

s. 244(1) — referred to

Companies' Creditors Arrangement Act, R.S.C. 1985, c. C-36
Generally — referred to

s. 11.01(b) [en. 2005, c. 47, s. 128] — referred to

Courts of Justice Act, R.S.O. 1990, c. C.43
Generally — referred to

s. 101 — referred to

APPLICATION by secured lender for appointment of receiver; CROSS-APPLICATION by debtors for initial order under *Companies' Creditors Arrangement Act*.

***Mesbur J.*:**

Introduction:

1 I heard this application for the appointment of a receiver and the debtors' cross application for an initial order under the *Companies' Creditors Arrangement Act*[1] (CCAA) on December 14, 2011. At the end of the hearing I made the following endorsement:

> For reasons to follow, an order will go in the following terms:
>
> a) The debtors' cross application for an initial order under the CCAA is dismissed.
>
> b) The application to appoint a Receiver is granted, but will not take effect until 5:00 p.m. on December 20, 2011.
>
> c) If the debtor has obtained alternate financing & has paid the applicant in full by 5:00 p.m. December 20, 2011 then the Receivership Order will not take effect.
>
> d) If the terms of paragraph (3) [i.e. paragraph (c)] above have not occurred then the Receivership order will be with effect as of 5:01 pm December 20/11.
>
> e) If the parties cannot agree on the terms of the Receivership order (following the terms of the Model Order) they may make an appointment to settle the terms of the order.
>
> f) Even if the Receivership Order takes effect on December 20/11 at 5:00 pm nothing prohibits the Debtor from continuing its efforts to refinance.

2 Counsel tell me the debtor was unable to obtain financing to pay the applicant in full by December 20, 2011. Accordingly, the Receivership Order is now in effect, and it is necessary for me to deliver the reasons for my decision to appoint a receiver and decline to make an initial order under the *CCAA*.

3 These are those reasons.

The application and cross-application:

4 The applicant, Callidus, is the respondents' first secured lender. On this application, it sought the appointment of a Receiver under both the *Bankruptcy and Insolvency Act*[2] and section 101 of the *Courts of Justice Act.*[3] The TD Bank, who is the respondents' second secured lender, supported the receivership application. It pointed out none of the respondents' refinancing proposals included sufficient financing to retire the respondents' debt to the TD Bank. Accordingly, the TD Bank took the position that even if the respondents were able to find alternate financing sufficient to pay out Callidus, the TD Bank would bring its own application to appoint a receiver under the terms of its own security.

5 The respondents brought a cross-application for relief under the *CCAA*. Both Callidus and TD Bank opposed the cross-application.

Facts:

6 The respondent CarCap is in the business of sub-prime car lease financing. The respondent Cashland provides sub-prime equity car loans. Both companies are subsidiaries of CarCap Auto Finance Inc., which itself is a subsidiary of Kaptor Financial Inc. Kaptor Financial owns several other companies, either in whole or in part. The parties refer to these companies as the Kaptor Group. An individual named Eric Inspektor controls the entire Kaptor Group, either directly or indirectly.

7 The Kaptor Group, including the respondents, had deposit accounts with the TD Bank. Initially, they did not have any credit facilities with the TD. Both the respondents and the Kaptor Group had financing elsewhere. Before Callidus lent operating funds to the respondents, the Laurentian Bank provided an operating facility to them. In addition, the Kaptor Group used private investors to finance their businesses through separately incorporated special purpose investment vehicles. They refer to them as "silos". The silos provided funding either through secured term debentures or preference shares.

Callidus provides financing

8 On September 1, 2011 Callidus replaced the Laurentian Bank as the respondents' first secured lender. It did so pursuant to a credit facility agreement, under which it agreed to advance a demand loan of up to $15 million subject to certain margin conditions. The agreement provided that advances were to be used:

a) To pay off the existing indebtedness to the Laurentian Bank;

b) To repay certain silo investors;

c) To provide working capital; and

d) To finance existing and future vehicle lease and vehicle loan transactions.

9 Another term of the agreement required the respondents to establish "blocked" accounts at a bank. The respondents had to deposit all funds they received from all sources into these blocked accounts. The respondents established the blocked accounts at the TD Bank.

10 The Callidus credit facility had other provisions that are relevant to this application. The respondents' representations required them to disclose "all commitments of any lender (other than the Lender) for all debt for borrowed money, and all debt for borrowed money outstanding of the Borrowers or Corporate Guarantors."[4] The respondents did not disclose they owed

any money to TD Bank, although at the time they did. In fact, in the schedule where the respondents were required to list their "current debt defaults", they entered "none". This was not true. I will discuss this more fully in the section "Changes to the respondents' arrangements with TD Bank", below.

11 The respondents also represented that all the information they had given Callidus was "true and correct and does not omit any fact necessary in order to make such information not misleading." [5]

12 Callidus made its advances to a disbursement account that the respondents maintained. The disbursement account was also at the TD Bank.

13 The credit facility's terms provided that it was due on demand, and was repayable in full on the earlier of September 1, 2012 or an event of default. Remedies on default include Callidus' right to appoint a receiver and to apply to the court to appoint a receiver.

14 The credit facility is fully secured by general security agreements as well as a first ranking secured interest over the properties, assets and undertakings of the respondents.

Changes to the respondents' arrangements with TD Bank.

15 The respondents and other Kaptor Group companies initially had only deposit accounts with the TD Bank. Their banking arrangements did not include any overdraft or credit facilities. In July and August of 2011 the TD noticed what it characterized as a high rate of unusual activity in the respondents' accounts as well as in those of other Kaptor Group companies.

16 What was unusual is that more than $60 million in cheques passed through various Kaptor Group accounts. On August 18, 2011 about $18 million flowed through in a single day. TD Bank viewed this as unusual since the businesses generally had annual revenue of about $24 million. That day, the TD Bank froze the Kaptor Group accounts. When they froze the accounts, they were in an overdraft position of about $7 million, contrary to their banking arrangements with the TD.

17 TD Bank then entered into an accommodation agreement with the Kaptor Group, including the respondents. The accommodation agreement, which was dated August 23, 2011, provided a secured loan of $5 million to cover the overdraft, and to provide some working capital. The loan was to be repaid in full by August 29, 2011. It was not.

Callidus advances

18 Callidus knew nothing about the Kaptor Group/respondents' overdraft with the TD Bank, the accommodation agreement or their failure to repay the TD loan. On September 1, 2011 Callidus made its first advance into the respondents' disbursement accounts. The advance totalled just over $8.4 million and was used to pay out the Laurentian Bank debt, make payments to silo investors and provide working capital of just under $1 million. Clearly, given the respondents' situation with TD Bank at the time of the advance, the respondents were in breach of their representations to Callidus in the credit facility agreement.

The TD Bank's accommodation agreement is amended, then terminated

19 Since the TD Bank had not been repaid, it entered into an agreement to amend the original accommodation agreement. The amending agreement was dated September 7, 2011, a week after Callidus had advanced. The amending accommodation agreement provided for the Kaptor Group to acknowledge it was in overdraft at that date to the extent of $2.6 million. TD Bank agreed to advance up to $2 million (instead of the original $5 million) to cover the overdraft. TD Bank was to be repaid in full by September 12, 2011. Again, it was not.

20 On September 16, TD Bank entered into an agreement to terminate the accommodation agreement. In the termination agreement TD Bank agreed to extend the financing subject to certain paydowns, and with the requirement that the financing be paid in full by September 30. Once again, Kaptor Group failed to pay off the debt. It remains outstanding. Currently, the respondents owe the TD Bank about $1 million.

21 By this point the respondents had set up the required blocked account and disbursement accounts at TD Bank, and Callidus had advanced. By this point as well, TD Bank was no longer prepared to do business with the respondents. As part of its termination agreement with the respondents, TD Bank required them to transfer the blocked accounts and disbursement accounts within 90 days of September 16, 2011.

22 Before TD Bank made its various accommodation agreements with the respondents and Kaptor Group, there was a three week period in September where the TD Bank returned as NSF many cheques the respondents had written for payroll, investor payments and dealer and supplier payments. The NSF cheques to silo investors also put the respondents in breach of their obligations to Callidus.

Callidus learns of the debt with TD Bank

23 Callidus did not learn of any of the respondents' agreements with TD Bank, or the security they had given the Bank until three weeks after Callidus had made its first advance. It was only around that time that Eric Inspektor, who essentially controls the Kaptor Group, including the respondents, told Callidus that the respondents and other Kaptor Group companies maintained accounts with the TD Bank. He said that their arrangements with the TD Bank permitted the TD Bank to offset overdrafts in one corporate account against deposits in another, including the disbursement accounts into which Callidus deposited its advances to the respondents.

24 Mr. Inspektor explained that because of the overdraft position the Kaptor Group found itself in, the TD Bank had returned as NSF some of the cheques the respondents had written to some silo investors under Callidus' initial advance. It was one of the conditions of the advance that these investors were to be paid from the advance. Until this time, Callidus knew nothing of any debt the respondents owed to TD Bank. Callidus also did not know that one of the conditions of its initial advance had not been fulfilled - that is, paying off some specific silo investors.

25 Matters deteriorated. TD Bank dishonoured various Cashland cheques for things like payroll, dealership payments and business expenses. Dealers were complaining to the Ontario Motor Vehicle Industry Council.

The field audit

26 Under the terms of its security, Callidus was permitted to conduct a field audit of the respondents. When it did, it discovered that some government remittances were made late. It also learned that Mr. Inspector had directed funds in various Kaptor Group accounts to cover overdrafts in other accounts. This might have included diversion of funds from the respondents to cover overdrafts of other Kaptor Group companies. Over $300,000 in September lease and loan payments had been deposited into the disbursement accounts instead of into the blocked accounts. Mr. Inspektor and his wife deposited nearly $700,000 into the disbursement accounts instead of the blocked accounts. Again, this constituted a breach of the terms of the credit facility agreement.

The Callidus demand

27 Needless to say, all of this created significant concern for Callidus. Callidus took the position that the respondents had made misrepresentations and material non-disclosure to it. It viewed the respondents' actions as constituting material breaches of the credit facility agreement. It was not prepared to continue to lend. On October 18, 2011 it demanded payment in full, pursuant to the terms of the credit facility agreement. It also served notice under section 244 of the *BIA* of its intention to enforce its security.

The Callidus forbearance agreement and events following

28 On October 25, 2011 Callidus entered into a forbearance agreement with the respondents. Callidus agreed to forbear from enforcing its rights, but only on a day-to-day basis. The agreement permitted Callidus to terminate it at any time, in its sole and absolute discretion.

29 In the Callidus forbearance agreement the respondents have acknowledged Callidus' *BIA* Notices are valid. They agree not to contest the validity of the demands for payment. They waive the 10-day notice period, and consent to the immediate enforcement of Callidus' security.

30 The forbearance agreement also required the respondents to hire a new interim executive officer to replace Mr. Inspektor, who ceased to have any managerial role, or any cheque signing authority. The respondents also agreed to hire MNP corporate Finance Inc. to find them alternate financing so they could pay out Callidus by April 30, 2012. They were not able to secure alternate financing in this way.

31 The agreement also required the respondents to submit a complete restructuring plan to Callidus by November 30, 2011. First, the plan had to be acceptable to Callidus, and second had to be completed by December 31, 2011. The respondents have been unable to comply with either of these conditions.

32 Although the parties concede the term is not enforceable, the Callidus forbearance agreement also contains a promise from the respondents not to commence any restructuring or reorganization proceedings under either the *BIA* or *CCAA*.

33 Since the forbearance agreement, Callidus says the respondents' financial position has deteriorated more. The loan balance has increased by more than $770,000 while the lease rental stream has dropped by about $225,000. By the end of November, the respondents were in an over advance position of more than $1.2 million.

34 Callidus was not prepared to continue without changes to the arrangement. On November 16, Callidus told the respondents it would continue to fund under the credit facility if and only if there was a minimum cash injection at least $500,000 into the businesses by subordinated debt or equity within two days, and the respondents would also have to fund their 30% of the cost of buying new vehicles for lease. The respondents failed to fulfil either of these conditions.

35 On November 24, Callidus terminated the forbearance agreement, and told the respondents it would apply to court to have a receiver appointed.

36 Even though it has terminated the forbearance agreement, Callidus continues to provide some funding to the respondents. It does so at its discretion, in order to protect its security.

37 The respondents have been looking for alternate financing. They have not been able to secure any.

Discussion:

38 Callidus takes the position that the respondent made material misrepresentations even before the first advance. It says had it known of the respondents' situation with TD Bank it would never have agreed to advance in the first place. Now it sees the respondents' financial position deteriorating. Its demand for payment has not been satisfied. The respondents' revenue stream is declining, meaning it cannot acquire new vehicles to lease. Callidus says this results in a reduction of its security, while the debt increases. As a result, Callidus says it is just and convenient to appoint a receiver in order to protect its security and the interests of other stakeholders.

39 For their part, the respondents accuse Callidus of taking an aggressive and unreasonable position (even though every position Callidus has taken has been supported by the specific terms of either the credit facility or the forbearance agreement.) The respondents point out that they are not actually behind in their payments. They view the interim financial officer who is now in place as being akin to a "soft receivership", and suggested that if they were able to have a *CCAA* stay in place for thirteen weeks, they would be able to restructure. They did not, however, present any restructuring plan, even in very draft form.

Receiver?

40 Callidus brought its receivership application under both section 101 of the *Courts of Justice Act*, and s.47 of the *BIA*. The test to appoint a receiver under the *CJA* requires the court to conclude it would be just and convenient to do so. The court

may appoint an interim receiver under s. 47 of the *BIA* if and only if the court is persuaded a receiver is necessary to protect the debtor's estate or the interests of the creditor who sent a notice under s. 244(1) of the *BIA*.

41 The question is whether it is more in the interests of all concerned to have the receiver appointed or not. [6] In order to answer the question the court must consider all the circumstances of the case, particularly:

a) The effect on the parties of appointing the receiver. This includes potential costs and the likelihood of maximizing return on and preserving the subject property;

b) The parties' conduct; and

c) The nature of the property and the rights and interests of all parties in relation to it. [7]

42 Receivers are considered an "extraordinary" remedy, much in the same way as granting an injunction is considered an extraordinary remedy. The law is clear, however, that an applicant who wishes the court to appoint a receiver need not show irreparable harm if a receiver is not appointed. [8]

43 Many security instruments will specifically contemplate appointing a receiver. The fact that the creditor has a right to appoint a receiver under its security is therefore an important consideration. Generally, a court will appoint a receiver when it is necessary to enforce rights between the parties or to preserve of assets pending judgment. Receivers will also be appointed where there is a serious apprehension about the safety of the assets.

44 Here, of course, the credit facility agreement itself specifically contemplated appointing a receiver. Following the reasoning in *Fruere Village*, the "extraordinary" nature of the remedy is therefore less important here than it might otherwise be.

45 This leads me to consider the interests of all concerned, in order to determine whether the test under either the *Courts of Justice Act or Bankruptcy and Insolvency Act*, or both, has been met.

46 What is the likely effect on the parties of appointing a receiver? From Callidus' point of view, it will allow it to protect its security, and dispose of it in an organized and court-supervised fashion. It proposes to sell the businesses as a going concern, in order to maximize value for all stakeholders. The respondents concede that a possible restructuring plan might be to liquidate, in which case the hope would also be a going concern sale. In this regard, I see no difference in outcome if a receiver is appointed.

47 Callidus has legitimate concerns about the businesses continuing as a going concern while the respondents attempt to restructure. The respondents have stopped purchasing vehicles for lease. They have no money to do so. As a result, the value of Callidus' security is declining.

48 The activities in the TD accounts that led to the Bank's freezing them suggest companies that were out of financial control, operating outside of the normal course of business.

49 The respondents' difficulties with the TD Bank overdraft arose in August of last year. They have been given every opportunity since then to cure their defaults, and have failed to do so.

50 Similarly, the respondents have been in default with Callidus since it demanded payment in mid October of last year, and delivered its notice of intention to enforce its security. Even though Callidus had agreed to forbear, the respondents have failed to honour the terms of the forbearance agreement.

51 Neither Callidus nor TD Bank has faith in the respondents' management. This is a factor that supports appointing a receiver. [9] While the interim executive officer Mr. Willis has brought some stability to the businesses, they cannot operate without further borrowing, and none is available. Without further borrowing, the respondents cannot purchase new inventory for lease, and thus its inventory is declining. What this means is that its lease and loan revenues are also declining, while its

debt load to Callidus is increasing. All this suggests to me that appointing a receiver is necessary in order to protect Callidus' security from further erosion.

52 The respondents' past conduct also gives cause for concern if there is no receiver who can manage the businesses and arrange for an orderly sale under the court's supervision.

53 As to the nature of the property, I note that Callidus' security is declining in value. Both secured creditors' rights in it are being eroded. The court must put an end to the continued haemorrhaging of money. Given the respondents' failure to come up with even a rudimentary restructuring plan, it is time for a receiver to take control, and manage the businesses to the extent necessary to result in an orderly liquidation to protect the interests of all stakeholders.

54 At the hearing of the application and cross-application, the respondents urged me to consider only the current situation with the businesses, and look to the future, rather than to problems in the past. Even doing only this, there is no comfort to Callidus. The respondents have repeatedly sought new financing and failed - even after I made the receivership order, but held it in abeyance so they could refinance. Most importantly, nothing prevents the respondents from continuing their efforts to restructure, even though I have appointed a receiver.

CCAA?

55 The respondents took the position that granting an initial order under the CCAA is the proper way to proceed. They point to the fact that Mr. Willis (the interim executive officer) says the businesses are not out of control, are not a disaster, and are good businesses that will not deteriorate if a stay is granted and the companies are allowed to restructure. I disagree.

56 The respondents have no operating capital. They are borrowers in default, with two unwilling lenders who are unprepared to lend more. Under the *CCAA* these lenders have no obligation to advance more funds.[10] Without further advances, the respondents cannot continue to operate without further deterioration in inventory of vehicles and the resulting deterioration in revenue.

57 The respondents ask, what is the harm in letting them reorganize? While that is an interesting question, it is not the test. It seems to me this is nothing more than a last ditch effort on the respondents' part to stave off the inevitable. In *Marine Drive Properties Ltd., Re*[11] the court put a similar situation this way: "to put in bluntly, the Petitioners have sought *CCAA* protection to buy time to continue their attempts to raise new funding ... they need time to 'try to pull something out of the hat.'" Or, as Farley J. put it in *Inducon Development Corp., Re*,[12] "... *CCAA* is designed to be remedial; it is not however designed to be preventative. *CCAA* should not be the last gasp of a dying company; it should be implemented if it is to be implemented, at a stage prior to the death throe."

58 Here, the respondents only brought their application after Callidus had brought its application for a receiver. The respondents knew in November that Callidus intended to seek a receiver. They waited until they had been served with the receivership application before launching their own effort to restructure. As a result, the cross-application for *CCAA* relief seems more a defensive tactic than a *bona fide* attempt to restructure. The respondents have no restructuring plan. They have no outline of a plan. They do not have even a "germ of a plan". Again, as the court said in *Inducon*:

> [W]hile it is desirable to have a formalized plan when applying, it must be recognized as a practical matter that there may be many instances where only an outline is possible. I think it inappropriate, absent most unusual and rare circumstances, not to have a plan outline at a minimum, in which case then I would think that there would be requisite for the germ of a plan.

59 The respondents have been attempting to refinance for some time. They have failed to meet every deadline for payment they agreed to with Callidus as well as with the TD Bank. Even when I delayed the date for the receivership order to take effect in order to give the respondents time to complete a refinancing, they were unable to do so.

60 The absence of even a "germ of a plan" militates against granting relief under the *CCAA*.

61 Finally, in considering the question of whether to grant relief under the *CCAA*, I must also look at the position of the two major secured creditors. Neither will support a plan of arrangement. They represent a considerable part of the respondents' creditors. I have no evidence any other creditors would support a plan, either. I see no merit in making an initial order and imposing a stay in circumstances where a plan of arrangement is most likely going to be defeated.

62 Having considered all these factors, I decline to grant relief under the *CCAA*.

Conclusion:

63 It is for these reasons I made the order I did on December 14, 2011.

Application granted on certain terms; cross-application dismissed.

Footnotes

1 R.S.C. 1985 c. C-36

2 R.S.C. 1985 c. B-3 as amended

3 R.S.O. 1990, c. C-43, as amended

4 Credit facility agreement paragraph 17(k)

5 *Ibid.* paragraph 17(q)

6 *Bank of Nova Scotia v. Freure Village on Clair Creek* (1996), 1996 CarswellOnt 2328, 40 C.B.R. (3d) 274 (Ont. Gen. Div. [Commercial List])

7 *Bank of Montreal v. Carnival National Leasing Ltd.*, 2011 ONSC 1007 (Ont. S.C.J.) (CanLII)

8 *Swiss Bank Corp. (Canada) v. Odyssey Industries Inc.* (1995), [1995] O.J. No. 144 (Ont. Gen. Div. [Commercial List])

9 *GE Commercial Distribution Finance Canada v. Sandy Cove Marine Co.*, [2011] O.J. No. 2954 (Ont. S.C.J.)

10 Section 11.01(b) of the *CCAA*

11 (B.C. S.C.)

12 (1991) (Ont. Gen. Div.)

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 OR COMPROMISE OR ARRANGEMENT OF CASH STORE FINANCIAL SERVICES INC. et al

Court File No. CV-14-10518-00CL

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SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

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