

CITATION: Bonnie Cummings v. Peopledge HR Services Inc., 2013 ONSC 2781

COURT FILE NO.: CV 12-9896-00CL

DATE: 20130515

SUPERIOR COURT OF JUSTICE - ONTARIO

RE: BONNIE CUMMINGS IN HER CAPACITY AS ESTATE EXECUTRIX
OF THE ESTATE OF THE LATE JOHN CUMMINGS, Applicant

AND:

PEOPLEDDGE HR SERVICES INC., WINSTON PARK FINANCIAL
SERVICES LTD., CMC FRASER LTD., 1624452 ONTARIO LIMITED,
Respondents

BEFORE: Newbould J.

COUNSEL: *Joseph J. Bellissimo and Eleonore Morris*, for BDO Canada Limited
Geoff R. Hall, for the PMC-Sierra Ltd. and PMC-Sierra, Inc.
Jeffery Tighe, for Bonnie Cummings
Matthew Kanter, for Labatt Breweries of Canada LP
Michael McGraw, for Celergo Inc.

HEARD: May 9, 2013

ENDORSEMENT

[1] The receiver applies for a number of orders. The main issue is the method of distributing funds on hand to the various parties who have filed claims pursuant to a claims process previously authorized.

[2] Peopledge conducted business as a provider of payroll processing, human resources and benefits services. It serviced 152 Canadian customers and eight US customers. The estimated number of employees paid through its services was 9,926 in Canada and 482 in the US.

[3] Customers delivered funding for payrolls to Peopledge as well as payroll processing fees earned by Peopledge. Payroll funds were deposited into a "Canadian Consolidated Account" held with BMO to administer payrolls for customers with Canadian employees and a "US Consolidated Account" held with BMO Harris Bank in the US to administer payrolls for customers with US employees.

[4] There were no separate or designated trust accounts for deposits on a customer-by-customer basis. Thus when a customer deposited payroll funds, they were co-mingled with all other funds held in the particular Consolidated Account, including funds which had been deposited by other customers and with all funds from processing fees earned by Peopledge. Payroll payments were typically disbursed within three days. Payroll tax and other deductions could remain in the Consolidated Account for up to 45 days before being disbursed. Payroll processing fees earned by Peopledge and interest earned on the funds in the Consolidated Accounts were transferred to other corporate bank accounts held by Peopledge with BMO.

[5] The following claims relevant to this motion have been received by the receiver:

- (a) Customer Deposit Claims (estimated aggregate claim amount of \$5,714,718 for Canadian Customers and \$180,000 for US Customers): claims for amounts paid to Peopledge for the purpose of funding payroll services for which Peopledge did not complete the payroll or remittance processing and payment in whole or in part, certain of which Customers have asserted trust entitlement in respect of their Customer Deposit Claims.
- (b) Employee Claims (\$106,669.10 with possible priority claim of \$52,342.18): the receiver is aware that 18 former employees are owed a total of \$106,669.10 based on the employees' WEPPA claims. Of this amount, employee priority claims comprise a possible \$52,342.18.

- (c) CRA Claims (aggregate claim amount of \$59,359.37): CRA has made a source deduction claim and a HST against Peopledge, and as against 1624452 Ontario Limited for arrears of HST of \$5,644.63.
- (d) Secured Claims: Bonnie Cummings filed a claim on a secured and unsecured basis against all Debtors in the amount of \$64,217.76 with respect to certain professional fees funded in connection with the receivership.¹
- (e) General Claims (estimated aggregate claim amount of \$2,005,000): the majority of general claims were filed only as against Peopledge and are comprised of supplier, equity claims and Customer damage claims. Included in such claims is a General claim of \$488,641.22 filed by Peopledge's former landlord. There are also certain general claims filed with unspecified claim amounts.

[6] The receiver has determined that Peopledge's records and accounting practices make it difficult to identify and trace the claims of specific Peopledge Customers. However, the Receiver has been able to determine the following:

- (a) it appears all or a portion of payroll funds delivered to Peopledge by its Canadian Customers and its US Customers were intended by the respective Customer to be received and held by Peopledge segregated from other Peopledge funds and used to fund the respective Customer's payroll and governmental remittances;
- (b) despite its obligations to maintain trust or segregated accounts for all or a portion of its Customers, Peopledge did not segregate funds received from any one Customer, although Peopledge did maintain two distinct, but co-mingled, payroll

¹ During argument I expressed the view that the claim of Bonnie Cummings should be paid in the same way that the other professional fees were to be paid pursuant to the request for payment in this motion for the reasons contained in her affidavit of April 25, 2013 and the supplement to the fourth report of the receiver. It was agreed that counsel for the receiver and for Ms. Cummings would work out the mechanics of her claim to be paid now.

accounts for its Canadian Customers and US Customers by way of the Canadian Consolidated Account and the US Consolidated Account;

- (c) all funds received from Canadian Customers and US Customers were co-mingled in either the Canadian Consolidated Account or the US Consolidated Account;
- (d) the co-mingling of funds within each of the Canadian Consolidated Account and the US Consolidated Account may be a breach of trust or a breach of Peopledge's contractual obligations to some or all of its Customers;
- (e) the reporting ledgers and records of Peopledge did not track specific payments received from and made on behalf of Customers by Peopledge on a customer-by-customer basis;
- (f) funds were continually moved between the Canadian Consolidated Account, the US Consolidated Account and the other accounts maintained by Peopledge in the operation of its business;
- (g) the movement of funds between accounts also may be a breach of trust or a breach of Peopledge's contractual obligations to some or all of its Customers;
- (h) the receiver's initial review of the books and records of Peopledge and the accounts of the Debtors has revealed significant movement of funds from Peopledge's accounts to the accounts of related companies or other unknown accounts, the majority of which funds have not been located; and
- (i) the depletion of funds from the Canadian Consolidated Account and the US Consolidated Account also may be a breach of trust or a breach of Peopledge's contractual obligations to some or all of its Customers.

[7] Certain Customers have advised the receiver that they assert trust entitlements to funds in the receiver's possession.

[8] Based on the receiver's review of a small sample of Customer contracts in its possession, it appears that a Customer's arrangement with Peopledge will likely fall into one of three categories:

- (a) Customers having written contracts with Peopledge that expressly require Peopledge to hold the Customer's payroll funds in trust;
- (b) Customers having written contracts with Peopledge that do not expressly require the payroll funds to be held in trust but nevertheless require Peopledge to maintain some level of segregation of the payroll funds from other Peopledge funds; or
- (c) Customers who did not have any written contract governing their relationship with Peopledge.

[9] The receiver and its counsel have determined that there are significant factual and legal issues surrounding any express trust claims which would require significant costs to be incurred by the estates to review and analyze whether any particular estate funds are held in trust for any particular claimant or Customer, including:

- (a) assuming the existence of a written Customer agreement, reviewing each individual Customer contract with Peopledge to determine whether payroll funds delivered by the respective Customer were to be held in trust for the benefit of such Customer;
- (b) determining whether there could be differences between individual Customer contracts in respect of the scope of "trust" entitlements created;
- (c) determining whether, as between the Canadian Customers, there are priority issues between any trust Claims to the Canadian Customer account funds;
- (d) determining whether, as between the US Customers, there are priority issues between any trust Claims to the US Customer account funds;

- (e) determining whether there are priority issues as between competing trust claims between Canadian Customers and US Customers to the funds in the Canadian Customer account funds and the US Customer account funds;
- (f) determining whether there are traceable trust claims of Customers to any other pool of funds held by the Receiver; and
- (g) determining priority issues as between trust claims and any of the potential priority claims.

[10] It is clear that there will be insufficient funds in the estate to satisfy all of the claims in full and insufficient funds from the Canadian Customer account funds and the US Customer account funds to satisfy the Customer deposit claims in full. There are accepted Customer deposit claims of \$5.7 million against available funds in the estate net of receivership costs of \$2.9 million.

Analysis

[11] There are two main issues. The first is whether the Canadian and US Customer claims represent trust claims entitled to the entire Canadian Customer account funds and the US Customer account funds or whether they are unsecured claims like the other claimants so that all claimants would be entitled to these Customer account funds along with the other corporate bank account balances. The second is what method should be used to pay the Customer Customers in the event that they are to be treated as trust claimants. A third issue is the proper method of allocating receivership costs.

(a) Are the Customer claims to be treated as trust claims?

[12] I think it clear that it was never intended that Peopledge had any entitlement to the payroll funds deposited by a Customer other than the payroll processing fees earned by Peopledge. It is the receiver's view, which I accept, that all Customers provided their payroll funds to Peopledge on a same or similar "flow-through" basis regardless of the specific terms of their written contract, if any, with Peopledge. Payroll funds were deposited with Peopledge for a

specific and limited purpose, being the payment of employee wages and governmental and other remittances on behalf of the Customer.

[13] In these circumstances, it would appear to be inequitable to permit the general creditors of Peopledge other than the Customers who provided the funds to now be paid their claims from those funds. It was never intended that Peopledge or its creditors would have any beneficial interest in these funds. The issue is whether there is a basis in law to achieve this result. In my view there is.

[14] Mr. Hall submits that the proper legal framework for this case is that of a *Quistclose* trust. Funds were advanced to Peopledge for a specific purpose and a trust should be imposed in equity impressed to ensure that the funds are used solely for that purpose or returned to the parties who advanced the funds. This principle is based on the case of *Barclays Bank Ltd. v Quistclose Investments Ltd.*, [1970] AC 567 (HL).

[15] In *Quistclose*, a lender lent money to a company on the condition that the loan was to be used to pay a dividend. The lender's cheque was paid into a separate bank account at Barclays who knew the money was borrowed and who agreed the account would be used only to pay a dividend and for no other purpose. Before the dividend was paid, the company went into liquidation. It was held by Lord Wilberforce that the arrangements gave rise to a relationship of a fiduciary character or trust in favour of the lender who on the advancement of the loan had acquired an equitable right to see that it was applied for the designated purpose. Lord Wilberforce relied on authority that held that money advanced for a specific purpose did not become part of the bankrupt's estate. What was important was that it was the mutual intention of the parties that the payments to the company, as here, were not intended to be included in the company's assets. Lord Wilberforce stated:

These cases have the support of longevity, authority, consistency and, I would add, good sense.

[16] If any particular Customer of Peopledge had a trust agreement with Peopledge, this *Quistclose* type of trust would not be necessary to impress the payroll funds advanced to Peopledge with a trust. For any Customer of Peopledge without an express trust agreement, I accept that a trust as in *Quistclose* should be recognized.

[17] This result is consistent with modern Canadian authority such as *Soulos v. Korkontzilas*, [1997] 2 S.C.R. 217. In *Soulos*, McLachlin J. (as she then was) stated at para. 34 that a constructive trust may be imposed where good conscience so requires. She stated:

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.

[18] Under the umbrella of good conscience, constructive trusts are recognized to remedy unjust enrichment and corresponding deprivation. See McLachlin J. in *Soulos* at para. 20 and 43. In this case, Peopledge and its general creditors would be enriched by having the ability to access the payroll funds advanced by Customers to Peopledge. The Customers, and their employees, would be deprived by not having the funds paid to them and there would be no juristic reason for this to occur. It was never intended that Peopledge, or its creditors, would have any beneficial interest in the payroll funds advanced by Customers.

[19] Accordingly, I conclude that the Canadian Consolidated Account should be treated as a trust account for the Canadian Customers who advanced payroll deposits to Peopledge and the US Consolidated Account should be treated as a trust account for the US Customers who advanced payroll deposits to Peopledge. It is clear that Peopledge purposely used separate accounts for its Canadian and US Customers.

(b) Appropriate distribution method

[20] Despite its obligations to maintain trust or segregated accounts for all or a portion of its Customers, Peopledge did not segregate funds received from any one Customer, although Peopledge did maintain two distinct, but co-mingled, payroll accounts for its Canadian Customers and US Customers by way of the Canadian Consolidated Account and the US Consolidated Account. All funds received from Canadian Customers and US Customers were co-mingled in either the Canadian Consolidated Account or the US Consolidated Account.

[21] The Receiver is of the view that a distribution methodology should be selected which best balances the relative benefits and prejudices to the Claimants, applies a reasonably justified principled approach to Claimants' distribution and seeks to reduce further professional cost to the greatest extent possible to maximize Claimants' recovery.

[22] The receiver proposes an interim distribution methodology which it believes best accomplishes those goals in the circumstances. In particular, the receiver has recommended the following:

- (a) that the receivership costs be allocated on a *pro rata* basis against all property of the debtors in the possession of the receiver, including the Canadian Customer account funds, the US Customer account funds and the general estate funds), subject to two qualifications:
 - (i) first, the receivership costs should first be paid from the Ceridian referral fee prior to allocation to and payment from the other estate property;
 - (ii) second, in accordance with paragraph 17 of the claim process order, the receiver will continue to track all time incurred in reviewing, validating and resolving any discrepancies with each of the claimants on an individual basis and thus, if deemed appropriate by the Court at the time based upon the final reconciliation by the receiver, the specific fees and disbursements associated with such review and resolution of individual claims can be allocated to and payable from any future final distributions to such claimant;
- (b) that only those claimants with proven Canadian Customer deposit claims receive a distribution from the Canadian Customer account funds which distributions be on a *pro rata* basis, subject to prior payment of the allocated portion of the receivership costs;
- (c) that only those claimants with proven US Customer deposit claims receive a distribution from the US Customer account funds which distributions be on a *pro*

rata basis, subject to prior payment of the allocated portion of the receivership costs;

- (d) that the 162 HST claim, if and to the extent proven, be paid from the funds of 162 in priority to all other proven general claims but subject to prior payment of the allocated portion of the receivership costs;
- (e) that the potential priority claims (other than the 162 HST claim), if and to the extent proven, be paid from the Peopledge general account funds in priority to all other proven general claims but subject to prior payment of the allocated portion of the receivership costs; and
- (f) that any claimants with proven general claims (including the deficiency portion of any proven Canadian Customer deposit claims and proven US Customer deposit claims) receive a distribution from the remaining balance of the general account funds which distribution be on a *pro rata* basis subject to payment of any proven potential priority claims and the prior payment of the allocated portion of the receivership costs.

[23] The receiver has reviewed a number of possible scenarios for distributing the funds on hand. In coming to his recommended scenario, the receiver has had regard to the following:

- (a) given the facts in this case, including the co-mingled nature of Peopledge's consolidated payroll accounts, no single Customer will likely be able to successfully establish that any particular dollar in the estate is subject to an express trust in favour of such Customer;
- (b) similarly, it is unlikely that any Customer would be able to successfully establish that it can trace any funds held in trust (if so established) into Peopledge's general accounts or the related companies' accounts;
- (c) the time and expense that would be associated with reviewing, assessing and potentially litigating competing express trust claims is likely to be considerable and may be unwarranted given the number of Customers that have filed customer

deposit claims (79 Customers for a total of \$5,714,718) and the total funds in the estate (\$2,914,148.09 after incurred and estimated continuing receivership costs);

- (d) as with the potential express trust claims, the time and expense that would be associated with reviewing, assessing and potentially litigating such claims and remedies is likely to be considerable and may be unwarranted in the circumstances;
- (e) given that it appears that all Customers would have provided their payroll funds to Peopledge on the same or similar "flow-through" basis regardless of the specific terms of their written contract, if any, with Peopledge and given the time and expense that would be required for the receiver to review and analyze all of the Customer contracts (including seeking to obtain copies of any contracts not found in Peopledge's records), it appears that a detailed review of all Customer contracts is also not warranted in the circumstances;
- (f) Claimants with general claims should not unduly benefit to the detriment of claimants with Customer deposit claims from Peopledge's breach of its trust or other obligations to the Customers;
- (g) conversely, the general estate funds were not established by Peopledge to hold the payroll funds, and thus Claimants with general claims should not be unduly prejudiced by extending any Customer trust to the general estate funds;
- (h) the Customer deposit claims represent approximately 81% of all claims filed and, together with the general claims of Customers as filed, the Customers represent approximately 89% of all claims filed;
- (i) as between the Customers claiming against the Canadian Customer account funds or the US Customer account funds, as applicable, given the poor accounting practices of Peopledge it would likely be very time consuming and costly, if not impossible, to determine Customer entitlement based on accounting principles such as "first in, first out" or the "lowest intermediate balance rule" which the

receiver understands has been applied in certain co-mingled trust cases (which may have different factual basis than the case at hand); and

- (j) the receiver also notes that applying such accounting principles may unduly benefit or detriment any particular Customer simply based on the date selected for determination.

[24] There have been several cases in Ontario dealing with the method to be used in distributing money that was to be held in trust but co-mingled into an account from which money was improperly taken and not used for the purposes for which the money was advanced by claimants. The receiver points out that there have been two possible methods recently used in Commercial List cases. One method is referred to as the *pari passu ex post facto pro rata* method, or the “*pro rata*” method. The other is referred to as the Lowest Intermediate Balance Rule (“LIBR”). In my view the *pro rata* method recommended by the receiver is the appropriate method to use in this case. It is to be noted that no one who appeared contended for the LIBR method to be used.

[25] The *pari passu ex post facto pro rata* approach is a *pro rata* distribution to claimants based on the amount of their original contribution to a fund, regardless of when the fund was co-mingled. Under the LIBR approach, a claimant to a mixed fund cannot assert a proprietary interest in the fund in excess of the smallest balance in the fund during the interval between the original contribution and the time when a claim with respect to that contribution is being made against the fund. With the LIBR method, a claimant’s *pro rata* distribution from the fund is therefore based on the “lowest balance” of their original contribution, which, depending on the flux of intervals, can be deemed as \$0. The method to be applied can have significant financial consequences for the parties.

[26] The appropriate method of allocating funds in a mingled trust fund was dealt with by Morden J.A. in *Ontario Securities Commission v. Greymac Credit Corp.* (1986), 55 OR (2d) 673 (CA), aff’d 59 OR (2d) 480 (SCC). That case stands for the proposition that the LIBR method should be used if the analysis can be done. In *Boughner v. Greyhawk Equity Partners Limited Partnership (Millenium)* [2013] O.J. No. 231 (C.A.) the Court of Appeal affirmed that the

general rule enunciated in *Greymac* continued to be the appropriate method, absent an inability to undertake a tracing. The Court in *Boughner* stated:

The general rule, and the preferred allocation method, in cases like this is, per *Greymac*, the LIBR method. In some cases, as in *Law Society*, this method will not be appropriate because, as Blair J.A. (*ad hoc*) said at para. 33, "it is manifestly more complicated and more difficult to apply." Thus the law in Ontario is as expressed by Morden J.A. in *Greymac* at para. 46:

While it might, possibly, be appropriate in some circumstances to recognize claims on the basis of a claimant's original contribution ... I do not think that it is appropriate where the contributions to the mixed fund can be simply traced, as in the present case.

[27] In *Law Society of Upper Canada v. Toronto-Dominion Bank* (1998), 42 OR (3d) 257 (CA), leave to appeal to Supreme Court of Canada dismissed [1999], S.C.C.A. No. 77, the Court of Appeal applied the *pari passu ex post facto pro rata* method in distributing money in a mixed trust account. In that case, Blair J. (*ad hoc* at the time) determined that it was not practicable to conduct a LIBR exercise.

[28] Brown J. applied the *pro rata ex post facto pro rata* method in a very similar case to the before me in *T.D. Bank v. 2026277 Ontario Inc.*, [2012] O.J. No. 2369. I agree with this approach.

[29] Unlike *Boughner*, this is not a case in which it is practically possible to make LIBR calculations. Based on the report of the receiver, the contributions to the mixed fund likely cannot be traced and the expense in attempting to do so would not be warranted.

[30] I am satisfied that the appropriate method of determining payments to Customers for payroll fund claims is the *pro rata ex post facto pro rata* method.

(c) Allocation of receivership costs

[31] The receiver recommends that the receivership costs shall be allocated on a *pro rata* basis against all property of the debtors in the possession of the receiver, including the Canadian

Customer account funds, the US Customer account funds and the general estate funds, subject to two qualifications:

- (a) first the receivership costs should first be paid from the Ceridian referral fee prior to allocation to and payment from the other estate property;
- (b) second, in accordance with paragraph 17 of the Claim Process Order, the receiver will continue to track all time incurred in reviewing, validating and resolving any discrepancies with each of the Claimants on an individual basis and thus, if deemed appropriate by the Court at the time based upon the final reconciliation by the Receiver, the specific fees and disbursements associated with such review and resolution of individual Claims can be allocated to and payable from any future final distributions to such Claimant.

[32] The Ceridian referral fee arose pursuant to an agreement made between the receiver and Ceridian Canada Ltd., under which 72 customer payrolls were transferred to Ceridian, resulting in a net referral fee to the receiver of \$461,055.26 for the benefit of the receivership estate. In formulating the proposed distribution scenario the receiver has not treated the Ceridian referral fee as an estate asset for distribution purposes but has assumed the full utilization of it to pay receivership costs incurred with the balance of the receivership costs being allocated *pro rata* against the property.

[33] The Receiver has approached it on this basis given that the Ceridian referral fee is not an asset of the Peopledge estate that existed pre-receivership but is instead an asset that has been created solely as a result of the receivership and the agreement entered into between the receiver and Ceridian. Thus, the Ceridian referral fee can logically be first fully utilized to pay receivership costs before the pre-existing property of the estate is allocated to satisfy receivership costs. It does, however, result in the recovery for general claims, which include any Customer's general claims, to be 5.4% lower than if the Ceridian referral fee were included as an asset of the estate.

[34] In my view, the allocation of the receivership costs as proposed by the receiver is reasonable, and it is approved.

Other matters

[35] The other heads of relief sought are straightforward and are approved, including the approval of the conduct and activities of the receiver set out in its third and fourth reports. The fees and disbursements of the receiver and its counsel are reasonable and approved.



Newbould J.

Date: May 15, 2013