CITATION: TD Bank v. 2026227 Ontario Inc., 2012 ONSC 2992
COURT FILE NO.: CV-11-9336-00CL
DATE: 20120528

SUPERIOR COURT OF JUSTICE – ONTARIO

COMMERCIAL LIST

RE: The Toronto-Dominion Bank, Applicant

AND:

2026227 Ontario Inc., Respondent

BEFORE: D. M. Brown J.

COUNSEL: F. Sulley, for BDO Canada, the Interpleaded Fund Advisor

J. Berman, Q.C., for 2026227 Ontario Inc.

G. Bowden, for The Toronto-Dominion Bank

M. Huneault, for Carriere Industrial Supply Limited, claimant

H. Desbrisay, for the DiBrina Group, claimants

S. Singh, for Canada Revenue Agency

HEARD: April 4, 2012

REASONS FOR DECISION

I. Motion for directions concerning the distribution of interpleaded funds

[1] At issue on this motion is the determination of the proper methodology by which to distribute to claimants funds paid into court following the demise of 2026227 Ontario Inc., which carried on business as Time + Plus Canada. 202 provided payroll processing services to its clients. It held a Payroll Account and a Tax Account at the Toronto-Dominion Bank. 202 ceased operations about one year ago. Pursuant to the order of Low J. made June 28, 2011 the TD Bank paid into court the sum of $2,398,786.75 which largely consisted of funds held in 202's Payroll Account with the Bank.

[2] By order made November 14, 2011, I appointed BDO Canada Limited ("BDO") to act as the Interpleaded Fund Advisor and authorized a process by which clients of 202 could make claims against the Interpleaded Fund.

[3] Following the completion of the claims process, at an April 4 hearing the parties made submissions about the basis upon which the funds should be distributed to claimants. Some argued that the Fund should be distributed on a *pro rata* basis amongst the claimants; others contended that to the extent funds could be attributed to a specific claimant, they should be returned to that claimant, with the balance distributed *pro rata*. I reserved on that question, but approved the fees and disbursements of the Fund Advisor and ordered that following the release of these Reasons the Fund held in court was to be paid to BDO for distribution after the expiry of any appeal period.

II. Background facts

A. The payroll services provided by 202

[4] 202 provided payroll services to franchisees, the customers of which constitute the claimants to the interpleaded Fund. As part of its payroll service 202 would pull funds directly from a customer's bank account into its Payroll Account and then transfer them into the accounts of individual employees of the customer. In addition, 202 would withdraw funds from a customer's account into its Payroll Account and then push them to a 202 Tax Account from which it would remit the necessary statutory deductions on behalf of the customer to the Canada Revenue Agency, Ontario Ministry of Revenue and Quebec Ministry of Revenue. Such remittances for statutory deductions were performed at regular time intervals.

[5] As a matter of mechanics, any "pull" from a customer's bank account would consist of (i) the net payroll due to employees and (ii) the required tax remittance amounts. In some cases 202 also would pull a payroll processing fee. The funds pulled were deposited into a Payroll Account maintained by 202 with the Toronto-Dominion Bank. On the day following the "pull" 202 would segregate the amounts drawn into the amounts pushed out to each employee's bank account and the tax remittance amounts which were transferred into 202's Tax Account at the Bank.

B. The consequences of the overpayment to CRA: January 6, 2011

[6] On January 6, 2011, a clerical employee of 202 mistakenly pushed an amount of $2,349,544.96 to CRA from the Tax Account when the proper remittance amount was only $655,665.72. As a result, CRA received an overpayment of $1,693,879.24. The January 6 push to CRA put 202's Tax Account into overdraft.

[7] Upon discovering the mistake 202 contacted CRA seeking a return of the overpayment. CRA took the position at the time that it could not return any of the overpayment because the funds had been ear-marked with customers' specific tax account numbers.

[8] Although that overdraft was soon covered by subsequent deposits into the Tax Account pulled from other customers, the overpayment to CRA soon placed significant financial pressures on 202, with increasingly large overdrafts showing in the Tax Account.

[9] By the end of January the Bank refused to permit further increases in the overdraft on the Tax Account. By January 26 the overdraft in the Tax Account stood at $1,040,284.43. The

Bank transferred that amount into a demand loan facility, bringing the balance in the Tax Account to zero by January 31.

[10] Notwithstanding this step by the Bank, 202 continued to provide payroll services and pull amounts from customer accounts into its Payroll Account. 202 made one further deposit to its Tax Account on February 7, 2011 - $842,915.00 - and one further remittance of source deductions to CRA on the same day - $843,066.53. The Tax Account then remained inactive. The Bank closed the Tax Account on March 9, 2011.

C. The payments into court

[11] On March 4, 2011 the Bank obtained an order from Himel J. authorizing it to pay into court the net amount of $2,514,230.55. That amount corresponded to the sum drawn by the Bank from 202's Payroll Account.[1] As a result of certain refunds to customers subsequently made by the Bank, on June 28, 2011 Low J. varied the interpleader order to reduce the amount payable by the Bank into court to a net amount of $2,397,786.75. The Bank paid those funds into court on September 15, 2011.

D. Analysis by the Interpleaded Fund Advisor

D.1 Genesis of the examination of the February 7 to 10, 2011 transaction period

[12] On November 14, 2011, I appointed BDO Canada Limited as the Interpleaded Fund Advisor. BDO has filed four reports: its First Report of December 26, 2011 and a supplement dated February 9, as well as a Second Report of March 8, 2012 and a supplement dated March 30, 2012. BDO had provided some advice to 202 in early 2011 as problems arose following the overpayment to CRA.

[13] The November 14 Appointment Order directed BDO to assist the Court "in determining those persons who are entitled to participate in the distribution of the monies constituting the Fund and in furtherance thereof to submit its recommendations by way of one report or more to the Court". At the hearing on November 14, 2011 counsel for 202 had circulated a document which he submitted showed the last four days of pulls from customers' accounts from February 7 to February 10, 2011 (the "November 14 List"). He advised that the November 14 List might disclose traceable funds for distribution. Consequently, the Appointment Order contained the following additional direction to the Fund Advisor:

> THIS COURT ORDERS that the Fund Advisor shall provide an initial report to this Court on or before December 16, 2011, or such other date as this Court may further order, with respect to the results of its determinations and recommendations in relation to

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[1] Ms. Koert, the Bank's representative, in her February 22, 2011 affidavit, broke down the amounts at that time as between the Payroll Account (5212006) and the Tax Account (5208115) as follows: Payroll Account - $2,518,210.79; Tax Account - $1,577.30.

the approximate sum of $1,612,064.97 which was pulled from the accounts of Customers by 202 on February 7, 2011 to February 10, 2011, inclusive.

D.2 BDO's First Report: December 16, 2011

[14] To examine the information shown on the November 14 List BDO reviewed the bank statements for 202's Payroll Account for the February 7 to February 10, 2011 period. In its First Report of December 16, 2011, BDO reported that the November 14 List did not record monies pulled from customer accounts, but showed tax remittance amounts owing to CRA.

[15] BDO conducted its own examination, based on 202's bank records, of funds pulled and remitted between February 7 and February 10. Using the transfer of $842,915.00 on February 7 from 202's Payroll Account to its Tax Account as a starting point, BDO concluded that that transfer "represented co-mingled funds" and it could not "justify tracing funds to dates or times earlier than that of mid-day February 7, 2011". Following that February 7 transfer BDO was able to identify several subsequent pulls by 202 of funds from customers and related pushes to employees up until the evening of February 9. BDO reported that 202 failed to make some of the remittances to CRA due from those pulled funds. Based on that analysis BDO reported:

> 5.11 ...The result of that adjustment would be to calculate an amount of $918,799.19 as representing the comingled funds, with the remaining balance of $1,599,411.60 in the account representing traceable funds related to the pulls and pushes on February 7, February 8 and February 9, 2011.
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> ...
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> 8.1 Having reviewed the banking transactions set out in the Payroll Account bank statement for February 7 to February 9, 2011, the Fund Advisor is of the view that the transactions occurring after the transfer out of the Payroll Account of $842,915.00, about mid-day on February 7, 2011, consisting of the pulls and pushes from the evening of February 7 to the close of business on February 9, 2011, inclusive, are traceable in that particulars of the pulls from customers can be identified, and the related pushes to the employees of those particular customers can also be identified.

[16] BDO stated that "from a practical point of view" since certain transactions could be identified and traced, the amounts involved should be refunded to affected customers. BDO placed a few caveats on its recommendation. First, it acknowledged that the characterization of the transactions and the entitlement of claimants to them was a matter of law, not practical accounting. Second, it observed that legal arguments existed that a push of $1,207,079.91 to employees on February 8, 2011 should be viewed as coming from co-mingled funds. Third, it commented that to the extent identifiable amounts were refunded to specific customers, the refunds should be reduced by amounts which particular customers might owe to 202 either through the overpayment of CRA on January 6 or as a result of various miscellaneous overpayments.

[17] As to the consequences of refunding traced transactions to specific customers (which it called "Traced Customers"), BDO commented that such an approach would benefit about 200 customers out of the approximately 500 customers owed money by 202 and would involve a

distribution of $1.3 million of the funds in court to specific customers. That would leave non-Traced Customers with claims of approximately $4 million sharing the remaining $1 million. BDO also made a proposal for the sharing of its costs between the Traced Customers and the other customers.

[18] One of the Traced Customers was Carriere Industrial Supply Limited, a company which provides wear products and services to the mining industry. An affidavit filed by its accounting manager, Mr. Dale Alexander, stated that on February 8, 2011, 202 pulled $910,528.97 from its bank account, transferred $189,696.69 to employee accounts, but failed to remit $720,832.28 to CRA and the Ontario Ministry of Finance.

D.3 The results of the claims process

[19] In early 2012 BDO administered the claims process approved in the Appointment Order. It provided a preliminary report of the results in its Supplement dated February 9, 2012 and a more definitive account in its Second Report dated March 8, 2012, together with its Supplement of March 30, 2012.

[20] BDO stated in its Second Report that it had received and accepted 416 claims from 202 customers totaling $5,098,381.52. Of those accepted claims, 176 claimants with claims of $1,287,596.30 fell into the category of funds pulled by 202 from customer accounts from February 7 to February 9, 2011, representing unremitted payroll deductions for gross payrolls. If the amounts identified for the Traced Customers were paid out of court to them, BDO reported that eight of the claimants ($673,404.63) would see 100% recovery of their claims, with the remaining Traced Customers seeing significant, but not full, recovery. The remaining 240 claimants which did not have funds pulled from their accounts from February 7 to 9, 2011 submitted claims of $2,777,838.95. If identified amounts were paid out to the Traced Customers, the non-Traced Customers would share in the remaining $1,110,190.45 in the Fund.

[21] In the claims process Carriere Industrial filed a proof of claim in the amount of $619,997.37 representing funds pulled on February 8, 2011, the amount of which was accepted by the Funds Advisor.

[22] BDO noted that in the claims process most affected customers netted against their claims the mistaken overpayment made to CRA to the extent that CRA had applied the overpayment to their on-going tax liability.

[23] Reverting to the caveats it had placed on its initial recommendation regarding distribution of the funds in court, in its Second Report BDO stated that several factors needed to be taken into account when considering whether the funds attributed to Traced Customers should be treated as traceable:

(i) If February 7 had not been selected as the start date for the identification process, "potential other funds pulled from customers' accounts could also be traceable, although the time and resources required to conduct the tracing exercise would result in significantly higher costs being expended";

(ii) A February 7 transfer of funds from Time Plus Newmarket Inc. ("TPN") complicated the analysis of whether funds were traceable;[2] and,

(iii) "Given the complexities of the tracing exercise if it were to extend to periods prior to February 7, 2011, it may be that the most equitable and convenient approach to take would be a *pro rata* distribution of the funds."

[24] BDO reported that if the funds held in court were paid out to all accepted claimants on a *pro rata* basis, the distribution to claimants (before taking into account professional fees) would be 47.03 cents on the dollar. If identifiable funds were returned to the 176 Traced Customers, the remaining claimants would see a recovery of 29.13 cents on the dollar. BDO now recommended that its professional fees should be allocated amongst all claimants on a *pro rata* basis using the amount of their final distribution.

III. Overpayment to CRA

[25] At the April 4 hearing CRA brought a motion to pay into court part of the overpayment ($460,000) it had received on January 6, 2011. I adjourned that motion so that counsel could engage in discussions on the matter.

IV. Positions of the parties

[26] BDO submitted that the Fund in court consisted of trust funds pulled by 202 from customer accounts and the only claimants to the Fund were beneficiaries of the trusts. The Fund Advisor observed that although the Fund came from a mixed trust account, "common sense" might dictate that the amounts owing to the February 7 to 9 Traced Customers should be paid to them in priority.

[27] One of those Traced Customers, Carriere Industrial, agreed, contending that the applicable general rule for distribution was that identified and traceable funds should be remitted to their rightful owner. Since BDO had identified some of the Funds as pulled from the account of Carrier Industrial, the company sought payment out of Court of its claim of $619,997.37.

[28] A different position was taken by eleven non-Traced Customers, collectively called the DiBrina Claimants,[3] whose accepted claims totaled $820,818.03. The DiBrina Claimants argued that the interpleaded Fund should be divided and distributed amongst all claimants in proportion to their respective accepted claims and that no claimant ought to enjoy a priority over any other claimant.

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[2] BDO clarified this point in section 3.2 of its Supplement dated March 30, 2012.

[3] DiBrina Sure Benefits Consulting Inc., DiBrina Sure Financial Group Inc., DiBrina Sure Human Resources Inc., DiBrina Sure Wealth Management Inc., Corpbeau Inc. o/a Pizza Hut, Doyle's Marketplace, Dr. Brian Clarke Dentistry Professional Corporation, Gagnon Opticians, Mid City Motor Sports Inc., Sudbury Auto Auction and Total Cable Contracting.

[29] The Bank submitted that it was indifferent to the method of distribution chosen because it made no claim to the money paid into Court. The Bank did request that the Court include the following language in its order:

> TD Bank and others assert claims against the funds overpaid to CRA on or about January 6, 2011. A portion of those funds has been netted out in the claims filed by some claimants. This order for a distribution of funds is without prejudice to TD Bank's claim to recover the over-payment to CRA.

No party objected to that language, so I therefore include it in the order resulting from these Reasons.

V. Analysis

A. The nature of the Payroll and Tax Accounts

[30] The Fund paid into court came from funds pulled by 202 from the accounts of its customers which it held for them in its Payroll Account, either to distribute to employees of customers or to remit to CRA or other tax authorities in satisfaction of source deduction remittance obligations of its customers. What were the legal natures of the Payroll and Tax Accounts?

[31] When the significant overdraft difficulties arose in early 2011, the Bank demanded that 202 retain a forensic accountant to investigate and report on the cause of the overdrafts. 202 retained BDO which prepared a report dated February 11, 2011 for the Bank and 202.[4] In that report BDO stated that 202 ran an operating account and a clearing account which were separate from the Payroll and Tax Accounts. It then considered whether the Payroll and Tax Accounts met the test for trust accounts. BDO concluded they did, reporting that "[t]hese funds have remained separate from the clearing and operating accounts which were created for the purpose of collecting management fees earned". BDO continued:

> [W]e believe that the funds received from the Companies' clients for net payroll and tax remittances represent funds held in trust for the benefit of the beneficiaries of that trust, namely the individual client's employees and the CRA. Accordingly, we are of the view that these funds are not assets of the Companies.

By the same token, BDO identified "numerous unsupportable transfers in and out of the Companies' tax accounts and accordingly we are of the view that a breach of trust may have occurred."

[32] At an earlier stage in this proceeding Persy Investments Ltd., a client of 202, or more specifically one of its franchisees, brought a motion for payment of funds to it. The supporting

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[4] Application Record of the Toronto-Dominion Bank filed February 22, 2011, Affidavit of Karen Koert sworn February 22, 2011, Exhibit "H".

affidavit of Marla Lambert attached the Service Agreement amongst Persy, the franchisee and 202. One of the recitals to the agreement provided:

> Whereas, Time + Plus Canada Inc. as part of its payroll services, payments are made at Time+Plus Canada Inc.'s direction to a Trust, established by Time+Plus Canada Inc...

In the "Direct Deposit" section of the agreement section 1 stated:

> The Client hereby agrees to sign in favor of the Trust with the signature of the present agreement, an authorization to transfer the payroll funds from the Clients bank account as per the attached void cheque to the Trust at least 2 business days in advance of the payroll due date.

From Persy's perspective, the funds pulled by 202 were placed into a trust account.

[33] The evidence also disclosed that Carriere Industrial viewed the 202 accounts into which its funds were pulled as trust accounts. In his November 1, 2011 affidavit Dale Alexander deposed:

> 8. ...TD Bank knew or ought to have known that TPC was providing payroll services to its customers and that further more any monies deposited to the trust account were trust monies. It is my understanding that TD Bank provided an overdraft on the trust account.
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> ...
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> 26. ...It appears that TD Bank had brought an application for an interpleader and had calculated the amount of trust monies it was holding to be in the amount of $2,520,256.55.

[34] At the April 4, 2012 hearing counsel for the Fund Advisor stated that it was agreed the Payroll Account was a trust fund for purposes of the distribution exercise. That the funds pulled from customers' accounts were held by 202 in trust for them was acknowledged by Carriere Industrial Supply in paragraph 54 of its factum.

[35] In my handwritten endorsement of November 14, 2011, I wrote: "Present information is that the funds in court represent funds "pulled" by 202 from client employers which never got "pushed" to CRA – i.e. the present understanding is that those funds are trust funds." The evidence which I just reviewed permits making more definitive findings of fact. Specifically, I find that the 202 Payroll Account and Tax Account were operated as mixed, co-mingled trust accounts for the benefit of customers from whose accounts funds were pulled for payment to employees and remittance to CRA; separate trust accounts were not maintained by 202 for each of its customers. 202 structured its bank accounts so that the Payroll and Tax Accounts into which client funds were pulled or transferred were kept separate and apart from the accounts 202

used for its own operational and clearing purposes.[5] The funds maintained in the Payroll and Tax Accounts continued to be identified as trust funds until the time that the Bank paid the funds remaining in the Payroll Account into Court. Accordingly, the distribution of the Fund in court must be assessed treating the Fund as the product of a mixed trust account.

B. Legal principles governing the distribution of funds to beneficiaries of a mixed trust account for which a shortfall exists

[36] The law concerning how to treat claimants to co-mingled trust funds where a shortfall remains in the trust accounts was set out by the Court of Appeal in its decisions in *Re Ontario Securities Commission and Greymac Corp.*[6] and *Law Society of Upper Canada v. Toronto-Dominion Bank:*[7] a trust account involving co-mingled funds should be distributed on a *pari passu ex post facto pro rata* basis where a shortfall exists in the account and the client deposits to the account are known. In adopting that principle of distribution the Court of Appeal rejected two alternative methods of effecting a distribution.

[37] First, in the *Greymac* case the Court of Appeal rejected the rule in Clayton's Case which applied a "first in, first out" principle to the state of accounts with the result that any shortfall was applied first to the first deposits made, with later contributors to the fund taking the benefit of what remains.[8] In the *Law Society* case Blair J. explained why the Court in *Greymac* had rejected the rule in Clayton's Case:

> Speaking for a unanimous Court in *Greymac*, Morden J.A. resolved that as a general rule the mechanism of pro rata sharing on the basis of tracing was the preferable approach to be followed, although he left room for other possibilities such as those circumstances where it is not practically possible to determine what proportion the mixed funds bear to each other, or where the claimants have either expressly or by implication agreed among themselves to a distribution based otherwise than on a pro rata division following equitable tracing of contributions (pp. 685-90). Whatever approach was chosen, Morden J.A. was concerned that it should be one which met the test of convenience - or "workability", as he termed it (p. 688). The core of the Court's conclusions is to be found in the following passage from his judgment, at p. 685:
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> > The foregoing indicates to me that the fundamental question is not whether the rule in Clayton's Case can properly be used for tracing purposes, as well as for loss allocation, but, rather, whether the rule should have any application at all to the resolution of problems connected with competing beneficial entitlements to a mingled trust fund where there have been withdrawals from the fund. *From the perspective of basic concepts I do not think that it should.* The better approach is

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[5] In *Graphicshoppe Ltd. (Re)*, [2005] O.J. No. 5184, the Court of Appeal concluded that the mingling of trust with non-trust funds prevented characterizing the fund in question as a trust account.

[6] (1986), 55 O.R. (2d) 673 (C.A.), affirmed (1988), 65 O.R. (2d) 479 (S.C.C.), [1988] 2 S.C.R. 172.

[7] (1998), 42 O.R. (3d) 257 (C.A.).

[8] *LSUC v. TD Bank, supra.*, para. 10.

> that which recognizes the continuation, on a pro rata basis, of the respective property interests in the total amount of trust moneys or property available.[9]

[38] Then, in the *Law Society* case, the Court of Appeal rejected the use of the "lowest intermediate balance rule" ("LIBR") under which a claimant to a mixed trust fund could not 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 made against the fund. Blair, J. described the rationale underlying the LIBR principle:

> [F]rom a review of the foregoing authorities, I take the rationale underlying the LIBR theory in relation to co-mingled trust funds to encompass at least the following concepts:
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> 1. that beneficiaries are entitled, through the equitable and proprietary notion of tracing, to follow their contribution into the mixed fund;
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> 2. that beneficiaries of a such a fund have a lien or charge over the totality of the trust fund to the extent of their interest in it;
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> 3. but that once a wrongful withdrawal has been made from the fund, the claims of beneficiaries with monies in the fund at the time of the withdrawal are thereafter limited to the reduced balance, and that depositors to the trust fund are not entitled to claim further against any subsequent amounts contributed to the fund either by the trustee (unless made with the intent to replenish the withdrawn amount) or other by other beneficiaries; and,
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> 4. that this inability to claim against anything in excess of the smallest balance in the fund during the interval between the original contribution and the time of the claim flows from the inability to claim a proprietary right to subsequent amounts deposited, since it is not possible to trace the original claimant's contribution to property contributed by others.
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> This latter concept is grounded, ultimately, on the premise that tracing rights are predicated upon the model of property rights. LIBR seeks to recognize that at some point in time, because of earlier misappropriations, an earlier beneficiary's money has unquestionably left the fund and therefore cannot physically still be in the fund. Accordingly, it cannot be "traced" to any subsequent versions of the fund that have been swollen by the contributions of others, beyond the lowest intermediate balance in the fund. Such is the theory, at any rate.[10]

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[9] *Ibid.*, para. 12, emphasis in the original.
[10] *Ibid.*, paras. 18 and 19.

[39] In the *Law Society* case the Court of Appeal rejected the LIBR for several reasons:

(i) It regarded a mixed trust fund as a whole fund or a blended fund;[11]

(ii) As a result, the timing of when the contribution by a particular beneficiary was made and when the event causing the shortfall occurred was irrelevant;[12]

(iii) The exercise required to conduct a LIBR exercise was impracticable where a large number of claimants existed,[13] even though LIBR "may be manifestly fairer in the pure sense of a tracing analysis".[14]

Consequently, the Court of Appeal adopted the *pari passu ex post facto* approach to *pro rata* sharing in cases involving a shortfall in a mixed trust account:

> In my view, the method which should generally be followed in cases of pro rata sharing as between beneficiaries is not the LIBR approach but the pari passu ex post facto approach, which has the advantage of relative simplicity. This approach involves taking the claim or contribution of the individual beneficiary to the mixed fund as a percentage of the total contributions of all those with claims against the fund at the time of distribution, and multiplying that factor against the total assets available for distribution, in order to determine the claimant's pro rata share of those remaining funds.[15]

[40] It is worth observing the similarities between the facts in the *Law Society* case and the present one. In the *Law Society* case, just prior to the freezing of the lawyer's trust account a bank had deposited $173,000 into the trust account. That deposit had occurred after the last misappropriation had taken place and at a time when the balance in the trust account was only about $66,000. The bank argued that it was entitled to the return of the $173,000, while the remaining trust beneficiaries could only claim against the $66,000. In applying the *pari passu ex post facto* approach the Court of Appeal rejected that argument, with the result that all claimant trust beneficiaries shared *pro rata* in the whole amount of the trust fund. In the present case, Carriere Industrial made a similar argument, pointing to the February 8, 2011 pull from its account and arguing that it was entitled to the return of that identifiable amount.

C. Carriere Industrial's argument that the decision of the Supreme Court of Canada in the *BMP* case directs a different result

[41] On their face the decisions of the Court of Appeal in the *Greymac* and *Law Society* cases would prevent such a recovery by Carriere Industrial. But Carriere submitted that other principles applied in the circumstances of this case. Specifically, Carriere submitted that the general rule of law is that identified and traceable funds should be remitted to their rightful

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[11] *Ibid.*, paras. 44 and 49.
[12] *Ibid*, para. 44.
[13] *Ibid.*, para. 40.
[14] *Ibid.*, para. 32.
[15] *Ibid*,. para. 34.

owner and the *pro rata* distribution approach set out in the Law Society case is an exception to that general rule. Since the Fund Advisor found that funds deposited into the Payroll Account on and after February 7, 2011, including funds pulled from Carriere's bank account, could be identified and traced, Carriere contended that the common law principle of tracing entitled it to recover its identified property.[16] In support of this argument Carriere relied heavily on the recent decision of the Supreme Court of Canada in *B.M.P. Global Distribution Inc. v. Bank of Nova Scotia.*[17]

[42] As put by the Supreme Court, the BMP case involved "a strangeness of its factual substratum".[18] Simply put, the case involved a forged cheque. BMP deposited the cheque into its account at the Bank of Nova Scotia. BNS placed a hold on it. The cheque was drawn on the account of First National Financial Corporation at the Royal Bank of Canada. RBC honoured the cheque and transmitted the funds to BNS which, in turn, deposited them into the account of BMP. The latter dispersed some of the funds to related parties and retained the balance. RBC then discovered that the cheque was a forgery. It demanded repayment from BNS. That bank immediately restrained funds in the account of BMP and the related parties amounting to roughly 85% of the face value of the cheque. BNS remitted to RBC those restrained funds. BMP and the related parties then sued BNS for damages in the amount of the restrained funds. Although successful at trial, BMP failed at the appellate levels.

[43] The Supreme Court of Canada held that RBC was *prima facie* entitled to recover the funds paid under a mistake of fact to the recipients and that none of the bars to recovery articulated in the *Simms*[19] test were present. Having found that BMP had no defence to RBC's claim for restitution for monies paid under mistake of fact, the Court then turned to the question of whether any rule of evidence barred recovery by RBC. At this point the Court considered the issue of tracing, which it described as "an identification process",[20] and stated the basic rule as follows:

> The common law rule is that the claimant must demonstrate that the assets being sought in the hands of the recipient are either the very assets in which the claimant asserts a proprietary right or a substitute for them.[21]

[44] No issue existed on the facts of the *BMP* case that the funds held in BMP's account at BNS came from the funds received from RBC; the Court found that restitution was available to RBC. The issue then became whether restitution was available in the case of the funds held in the bank accounts of the related parties. The Court held that it was, concluding that at common law it is possible to trace funds into bank accounts if it is possible to identify the funds.[22] In

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[16] Factum of Carriere Industrial Supply, paras. 44 to 48.
[17] [2009] 1 S.C.R. 504.
[18] *Ibid.*, para. 93.
[19] *Barclays Bank Ltd. v. W.J. Simms Son & Cooke (Southern) Ltd.*, [1979] 3 All E.R. 522 (Q.B.).
[20] *BMP, supra.*, para. 75.
[21] *Ibid.*, para. 75.
[22] *Ibid.*, para. 85.

reaching that conclusion the Court stated that the mixing of funds in the bank account was not a bar to recovery,[23] and then the Court adverted to the very specific facts of the situation of the related parties:

> Suffice it to say that, as between innocent contributors, contributions are followed first to amounts they have withdrawn. In the case at bar, since the withdrawals of all those who received funds far exceeded their contributions, RBC can trace its own contribution to the balances remaining in the accounts.[24]

That led the Court to conclude:

> [T]he question to be asked is whether the money deposited in those accounts was "the product of, or substitute for, the original thing". In the instant case, the identification process is quite simple. I will not go back over the issue of the funds in BMP's account: there was no relevant movement of funds. Regarding the funds in the related accounts when BNS acted on BMP's instructions and transferred money to the accounts of 636651 B.C. Ltd., Backman (chequing and savings accounts) and Hashka, the transferred funds were clearly related to the forged cheque BNS had mistakenly credited to BMP's account. The moneys used for the transfers came from BMP's account. The link is made with the funds RBC had used to pay the forged cheque.[25]

[45] I have reviewed in some detail the facts and the reasoning in the *BMP* case because it is apparent that the circumstances of that case differed markedly from the present one. First, *BMP* did not involve a trust fund. As the Supreme Court observed: "It is settled law that a customer is a creditor of the bank when he or she deposits funds into an account and that the bank holds these funds as its own until the customer asks for repayment." By contrast, the present case involves a trust account.

[46] Second, the *BMP* case did not involve claims by competing beneficiaries to a mixed trust fund in which a shortfall existed. Instead, *BMP* dealt with the ability of a payor to trace and recover monies paid under mistake of fact.

[47] Third, for a case which Carriere Industrial submits establishes a general principle to which the decisions in the *Greymac* and *Law Society* cases must bend, it is striking that in the *BMP* case the Supreme Court of Canada made no reference to either of those two cases. That was because *BMP*, as I read the decision, did not purport to alter the approach established by those cases for determining competing claims to a shortfall in a mixed trust account; *BMP* dealt with the completely different issue of how far along the trail a mistaken payor could trace the funds it had paid out.

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[23] *Ibid.*, para. 85.
[24] *Ibid.*
[25] *Ibid.*, para. 86.

[48] As I understand the *Greymac* and *Law Society* cases, the Court of Appeal has established a clear policy that the nature of a mixed or co-mingled trust fund is that of a whole or a blended fund. What follows from that policy was stated by that Court in the *Law Society* case:

> [T]he particular moment when a particular beneficiary's contribution was made and the particular moment when the defalcation occurred, should make no difference. The happenstance of timing is irrelevant. The fund itself - although an asset in the hands of the trustee to which the contributors have recourse - is an indistinguishable blend of debits and credits reflected in an account held by the trustee in a bank or other financial institution. It is a blended fund. Once the contribution is made and deposited it is no longer possible to identify the claimant's funds, as the claimant's funds. All that can be identified, in terms of an asset to which recourse may be had, is the trust account itself, and its balance.[26]

[49] In the *Law Society* case the affected bank argued that such an approach was unfair because it could look at the statements of the trust account and see that the last deposit came from its funds. Carriere Industrial makes a similar argument in this case. The Court of Appeal has acknowledged those arguments, going so far as to comment that LIBR might be "manifestly fairer" than the rule in Clayton's case,[27] but it has rejected those arguments for policy reasons.

[50] In my view the *pari passu ex post facto pro rata* approach to distribution applies to the facts of this case: the 202 Payroll Account operated, in effect, as a mixed, co-mingled trust account for the benefit of customers from whose accounts funds were pulled for payment to employees and remittance to CRA. A shortfall existed in that account at the time 202 ceased operations. The Fund in Court represents what remains of that mixed trust account. The principles articulated by the Court of Appeal in the *Greymac* and *Law Society* cases apply.

[51] I see no unfairness in that result to the Traced Customers for two reasons. First, the Fund Advisor did not conduct a complete audit of the Payroll Account. The reason BDO focused its analysis on pulled and pushed funds during the period February 7 to February 10, 2011 was the suggestion made by 202 about the significance of the November 14 List. BDO's concentration on that period of time did not reflect a judgment by BDO that only funds pulled during that period of time could be identified. As BDO noted in its Second Report, had February 7 not been selected as the starting date for the identification process, "potential other funds pulled from customers' accounts could also be traceable, although the time and resources required to conduct the tracing exercise would result in significantly higher costs being expended". BDO also reported that great expense would be involved in conducting a thorough tracing analysis of the Payroll Account and that "[g]iven the complexities of the tracing exercise if it were to extend to periods prior to February 7, 2011, it may be that the most equitable and convenient approach to take would be a pro rata distribution of the funds."

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[26] *Law Society, supra.*, para. 44.
[27] *Ibid.*, para. 51.

[52] The examination which BDO did conduct of the February 7 to 10, 2011 period simply flowed from the November 14 List tendered by 202 in court; it was not intended as a substitute for a thorough tracing exercise. Had a thorough tracing exercise been conducted, other customers might have been categorized as Traced Customers. The economics of this file prevented that from happening.

[53] Second, it was always open to Carriere Industrial, or any of the other Traced Customers, to insist that 202 hold funds pulled from it in a segregated account; it did not do so and must bear some consequences of the risk of placing its funds in a mixed account.

VI. Summary and directions

[54] By way of summary, for the reasons set out above, I conclude that the Fund in court should be transferred to BDO, as Fund Advisor, for distribution amongst the claimant beneficiaries by applying the *pari passu ex post facto pro rata* approach.

[55] The Fund Advisor reported that claimants in respect of which CRA had applied the January 6, 2011 overpayment against their tax obligations netted those overpayments for purposes of calculating their claims filed with the Fund Advisor. The DiBrina Claimants submitted that the *pro rata* entitlement of those claimants who benefitted from the CRA overpayment should be calculated on another basis, one which notionally treated the claimants as repaying the benefits they received by reason of the overpayment.[28] The Fund Advisor reported that "ideally" the total amount of the CRA overpayment should be returned to 202 for distribution, "but this may not be possible as a number of the claimants have apparently been able to offset these overpayments against other amounts owing by them to CRA, as a result of the under-remittances by 202".

[56] Exhibit 3 to the First Report of the Fund Advisor identified the 35 clients which received a "tax credit" from the January 6 overpayment of about $1.693 million. Carriere Industrial, for example, was credited $218,440.42 by CRA as a result of the overpayment when its actual tax liability at the time was only $57,631.81, a "tax credit" of some $160,808.61. Given the mixed nature of the trust account, much of that money would have come from other clients. In the ideal world described by the Fund Advisor, Carriere Industrial would pay back to 202 (or into court for distribution) the $160,808.61; the other 34 customers identified on Exhibit 3 would make similar types of paybacks.

[57] We do not live in an ideal world. In my February 13, 2012 Reasons I expressed "some concern about the costs incurred to date in this matter". The amount in issue, when the number of claimants is taken into account, means that one has to find a practical, economical way to distribute the funds, even if more work (and more expense) might result in a more "ideal" way. In my view the point has been reached in this file when proportionality and simple business common sense requires that a line be drawn, which is reasonable, even if not perfect.

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[28] See the Factum of the DiBrina Claimants, paras. 31 to 32.

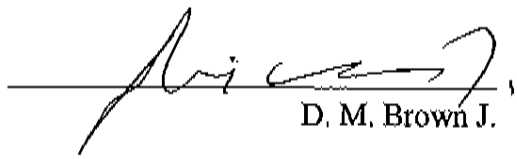
Accordingly, I direct the Fund Advisor to calculate the entitlement of the claimants who received a "tax credit" from the overpayment to CRA by treating their claims on the net basis as filed.

[58] I concluded, above, that as a matter of law the distribution of the Fund must proceed on a *pari passu ex post facto pro rata* basis. The application of that principle, coupled with treating the claims on a basis which nets any tax credit to a customer flowing from the January 6, 2011 overpayment to CRA, results, in my view, in a principled, convenient, workable and proportional treatment of competing claims against the shortfall in this particular fund.[29] Had the tracing approach advocated by Carriere Industrial prevailed, I would have thought that fairness and workability might require a different treatment of the effects of the overpayment to CRA.

[59] As to the fees and disbursements of the Funds Advisor, they shall be allocated *pro rata* amongst all claimants.

[60] Finally, the Fund Advisor sought direction as to whether its mandate should be expanded to include the collection of amounts owing to 202 by certain customers who received overpayments. Some claimants supported such an expansion. The Fund Advisor was appointed to deal with the Fund paid into court; the Fund Advisor was not appointed as receiver of 202. With the implementation of the directions set out above, the monies in court will be disbursed. Once that occurs the question then arises: where will the money come from to pay for any further work by the Fund Advisor? I am open to further submissions on expanding the mandate of the Fund Advisor, but those who advocate such a course must provide a concrete answer to that question. Since the parties are discussing how to deal with the interpleader motion which the Attorney General of Canada wishes to bring on behalf of CRA, they can address the practicalities of how to deal with any desired expansion of the mandate of the Fund Advisor on the next 9:30 before me.

[61] Since this was a motion for directions, generally I would not be inclined to award costs. However, if any party wishes to request costs it must serve and file with my office (c/o Judges Reception, 361 University Avenue, Toronto), within 10 days, written cost submissions together with a Bill of Costs.



D. M. Brown J.

Date: May 28, 2012

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[29] *Law Society, supra.*, para. 37.