

APPENDIX
XI

CITATION: Carriere Industrial Supply Ltd. v. The Toronto Dominion Bank, 2014 ONSC 6489
 COURT FILE NO.: CV-12-9838-00CL
 DATE: 20141107

ONTARIO
 SUPERIOR COURT OF JUSTICE

BETWEEN:

CARRIERE INDUSTRIAL SUPPLY
 LIMITED and DIBRINA SURE
 BENEFITS CONSULTING INC.
 Plaintiffs

)
)
) *J. Anthony Caldwell*, for the Plaintiffs
)
)

- and -

THE TORONTO-DOMINION BANK,
 2026227 ONTARIO INC., 2140074
 ONTARIO INC., JAMES GARLAND
 and JOHN DAVIS
 Defendants

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)
) *Gregory W. Bowden*, for the
) Defendant/Plaintiff by Cross-Claim,
) The Toronto-Dominion Bank
)

) *Jules N. Berman, Q.C.*, for the Defendants
) 2026227 Ontario Inc., 2140074 Ontario Inc.
) and James Garland
)

AND BETWEEN:

THE TORONTO-DOMINION BANK
 Plaintiff by Crossclaim

- and -

2026227 ONTARIO INC., 2140074
 ONTARIO INC. JAMES GARLAND
 and JOHN DAVIS
 Defendants to the Crossclaim

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) HEARD: January 13, March 17, 18 and 19,
) 2014
)

WILTON-SIEGEL J.

REASONS FOR JUDGMENT

[1] In this action, Carriere Industrial Supply Limited and Dibrina Sure Benefits Consulting Inc., as representative plaintiffs, seek an order requiring the Toronto-Dominion

2014 ONSC 6489 (CanLII)

Bank (the "T-D") to repay the sum of \$1,327,616 to BDO Canada Limited, in its capacity as the Interpleaded Funds Advisor (the "IFA") and an order that the T-D and 2140074 Ontario Inc. repay the amount of \$1,000,000 to the IFA, together with ancillary relief. By way of cross-claim, the T-D claims damages against 2026227 Ontario Inc., carrying on business as Time Plus Canada, and James Garland ("Garland") for fraud in the amount of \$1,040,284.43, together with an order for contribution or indemnity respecting any amount that it may be ordered to pay the representative plaintiffs, and ancillary relief. The representative plaintiffs and the T-D also asserted claims against John Davis, which have been discontinued on consent and without costs. In addition, Garland has consented to a judgment in favour of the representative plaintiffs in the amount of \$1,000,000 in respect of the claim against him in the same amount.

The Parties

[2] The defendant 2026227 Ontario Inc. is a corporation incorporated under the laws of Ontario that carried on business as Time Plus Canada (herein, "202" or "TPC"). In 2003, 202 acquired the business formerly operated by Time Plus Canada Inc. in a transaction described below.

[3] The plaintiffs were appointed representative plaintiffs in this matter by order of Cumming J. dated September 10, 2012. The plaintiffs represent, and are included in, a group of 416 claimants who were customers of TPC and its franchisees and who suffered a loss as a result of the events in January – March 2011 described below.

[4] James Garland was the president, and indirectly the controlling party, of TPC through the relevant period for purposes of this litigation. He has had a long business career, initially in senior marketing positions but latterly in owning and running private corporations in a variety of fields. Among other interests, he owned and managed a precision metal fabricating business for a period of eight years.

[5] The defendant 2140074 Ontario Inc. is a corporation incorporated under the laws of Ontario that carried on business as Time Plus Newmarket, (herein, "214" or "TPN"). 214 is a wholly-owned subsidiary of TPC, having been acquired as part of the transaction by which Garland acquired the business of Time Plus Canada Inc. through TPC. TPN is a franchisee of TPC. However, it did not commence carrying on business until 2009. Thereafter, it carried on business in the same manner as TPC in respect of its own clients, having the same types of bank accounts as are described below in respect of TPC.

The Business of TPC

[6] TPC, together with its franchisees, carried on the business of providing payroll processing and payment services to approximately 1,500 clients of the TPC franchisees (collectively, the "Business"), excluding TPN which appears to have carried on the same business directly with approximately 300 clients of its own on the same basis as TPC. TPC is, in turn, a licensee of Time Plus Inc., a corporation located in Atlanta, Georgia, which developed the original software program used by Time Plus Canada Inc. and TPC.

[7] In connection with the services provided by TPC and its franchisees, TPC had established three principal bank accounts with the T-D: (1) an operating account (the "Operating Account"), comprised of TPC's own funds; (2) a payroll account (the "Payroll Account"); and (3) a tax account (the "Tax Account"), comprising remittances due to the Canada Revenue Agency (the "CRA") and other collecting authorities (the "Collecting Authorities").

[8] TPC processed and paid payroll of the employer clients of its franchisees in the following manner. In respect of each payment date, TPC would aggregate the calculations of employee payments owing by the employer clients of TPC's franchisees, based on calculations prepared by the franchisees and transmitted electronically by them to TPC. Such calculations would also include calculations of the income tax and other deductions to be withheld and paid to the Collecting Authorities at a future date.

[9] It is significant that, whereas the funds in the Operating Account were those of TPC, the funds in the Payroll Account were funds of the employers whose payroll was to be paid within two days, and the funds in the Tax Account were funds of the employers and their employees that were owing to the Collecting Authorities. It is not disputed that the Payroll Account and the Tax Account were therefore trust accounts and the funds in such accounts were held by TPC in trust for the respective employers and their employees. Among other things, this reality was reflected in the TPC financial statements, which did not treat the monies in these accounts as assets of TPC.

[10] Pursuant to standing instructions received from the clients of TPC's franchisees, a transfer of funds would be initiated by an automated debit (referred to as a "pull") from the respective client accounts on the evening of the first day of a payment cycle. The debit amount for each client would comprise the total of: (1) the net payroll amount to be paid to the employees of such client; (2) the tax remittance amount for such client, including the employer portion of the remittance; and (3) the payroll processing fee that TPC and the respective franchisee charged the client, representing the revenue generated by TPC and the franchisee for providing the payroll service. The debit amount was deposited into the TPC Payroll Account at T-D.

[11] The following morning, on the second day of the payment cycle, the debit amount would be segregated and deposited in three separate transfers (each referred to as a "push") as follows:

- (1) The net payroll amount was transferred to T-D for direct deposit processing to the individual employee accounts, which was received in the morning on the fourth day of the payment cycle in such employee accounts;
- (2) The tax remittance amount payable to the Collecting Authorities was transferred to the Tax Account on the fourth day of the payment cycle; and

- (3) The payroll processing fee was transferred into the Operating Account via a clearing account on the fourth day of the payment cycle.

[12] Funds deposited into the Tax Account were held for remittance as source deductions to the Collecting Authorities in accordance with the frequency for filing of each particular client, which could be weekly, semi-monthly or monthly. While the transactions described above were all automated, utilizing software developed by TPC, tax remittances continued to be entered manually by a TPC clerk using a website established by the T-D for its commercial banking tax payment and filing service.

Garland's Acquisition of the Business

[13] Garland acquired control of the Business in 2003 in a transaction pursuant to which TPC purchased the assets and the ongoing business operations of Time Plus Canada Inc. on a going-concern basis for a nominal sum and the assumption of obligations estimated to be between \$250,000 and \$300,000 (the "Transaction").

[14] Garland controlled TPC through a holding corporation, 2026229 Ontario Inc. ("Holdco"), which was owned by two family trusts of Garland. Holdco owned 70% of the common shares of TPC. Gordon Haslem ("Haslem"), the owner of Time Plus Canada Inc., owned the remaining 30% of the shares of TPC. In the Transaction, TPC also acquired the shares of TPN, for which Haslem was paid \$150,000.

[15] Garland was introduced to the opportunity to acquire TPC by Randy Flewelling ("Flewelling"), a business development manager with the T-D who, together with another individual, was proposing to acquire Time Plus Canada Inc. and required financing. Garland declined that opportunity but subsequently reached an agreement with Haslem for TPC's purchase as described above.

[16] At the time of the Transaction, Time Plus Canada Inc. had agreements with 24 or 25 franchisees who had contracts with their employer clients for the payroll services that were administrated by Time Plus Canada Inc. and subsequently by TPC. The number of franchisees was subsequently reduced to 14 or 15 as described further below.

Banking Arrangements of TPC

[17] It is understood that the T-D had provided banking services to Time Plus Canada Inc. for approximately four years prior to the Transaction. After the Transaction, the T-D continued to provide the electronic banking systems required by TPC to provide its payroll processing services.

[18] In connection with the establishment of these banking arrangements in favour of TPC, Garland met with members of the Cash Management Group of the commercial banking division of the T-D. This Group was responsible for T-D's on-line electronic banking services to its clients. Accordingly, the Cash Management Group set up TPC's access to the T-D electronic banking services in order that the Business could continue after the Transaction as it had prior to the Transaction. The T-D acknowledges that, by virtue of its prior involvement with Time Plus Canada Inc., as well as its involvement in the

establishment of electronic banking services in favour of TPC, the T-D representatives in the Cash Management Group dealing with Garland and TPC were aware of TPC's business, including the fact that the Payroll Account and the Tax Account were trust accounts functioning as described above.

[19] TPC did not, however, request any line of credit or overdraft facilities. A small overdraft line of credit in favour of TPC did carry over from Haslam's management of Time Plus Canada Inc. for the first two years of TPC's operation of the Business but is not relevant for the issues in this litigation. In accordance with bank payment clearing rules, which allowed the T-D forty-eight hours to reject any cheque drawn on a TPC account that would put the account in an overdraft position, TPC effectively had to eliminate any overdraft existing at the end of any business day by the end of the following business day.

Management of the Business of TPC

[20] Throughout the period 2003 to 2011, Garland acted as the president of TPC. However, as Garland had no familiarity with the business of TPC and he understood that Flewelling did, TPC initially engaged Flewelling as its chief operating officer.

[21] Approximately six months after the Transaction, Garland replaced Flewelling with Ross Macdonald ("Macdonald") as president and chief operating officer. He concluded that Flewelling was not qualified, or sufficiently experienced, to manage a business of the size and complexity of TPC. As a franchisee, Macdonald had more experience and an ability to understand the problems facing TPC. However, Macdonald left the position after one year as he decided not to relocate to Newmarket near the offices of TPC.

[22] Since that time, TPC has been run under Garland's supervision by a processing clerk supervisor, upon whom Garland appears to have placed considerable reliance, a bookkeeper and clerical staff.

[23] Pursuant to a management agreement between TPC and Garland's personal corporation, Desom Systems Incorporated ("Desom"), TPC paid Desom an annual management fee for Garland's services, bookkeeping services and ancillary services, which collectively totaled \$75,000. These fees, and the fees due to franchisees for their services, were paid out of the Operating Account.

Financial Challenges of TPC

[24] Garland says that the business of TPC faced several significant problems:

[25] First, Garland acknowledges that Flewelling advised him that earlier due diligence conducted with respect to TPC indicated that there was a possible deficit of between \$250,000 and \$300,000 in the Tax Account. He says that Flewelling explained this deficit as a result of timing differences between the receipt and payment of funds but, as Flewelling did not testify, this cannot be verified. In any event, Garland's subsequent decision to dismiss Flewelling for lack of competence or experience would have made Garland question the reliability of Flewelling's understanding of TPC's operations. Garland says he hoped to eliminate the deficit on a going-forward basis by introducing operating efficiencies, selling

new franchises and reducing non-performing franchises. Garland says he now believes that the deficit was in excess of \$1 million at the time of the Transaction.

[26] Second, Garland was unable to sell additional franchises to parties who had expressed an interest due to negative reports from current and former franchisees related to legacy issues associated with bad service. In an attempt to address this concern, Garland converted the operations of TPC to a fully automated platform, apart from the manual entry of tax remittances to the Collecting Authorities, which was the source of the error giving rise to the demise of TPC.

[27] Third, Garland says the business model was flawed in that it was not profitable. He says that the fees that were collected from employers for the payroll processing services, which had been established by Time Plus Canada Inc., were insufficient to cover expenses including bad debts and fees payable to the CRA for late payments. Garland apparently considered that TPC could not raise these fees.

[28] Garland acknowledged on his examination-for-discovery that, as a consequence, TPC used "surplus funds" in the Tax Account -- by which he meant funds not immediately required to fund tax remittances -- to pay operating expenses of TPC, including the cost of the software upgrade described above. In other words, Garland caused TPC to fund its working capital requirements by accessing monies in the Tax Account. Garland estimates that an average of \$65,000 per year was withdrawn from the Tax Account to fund TPC's operating expenses over the period 2003 to 2011, which totals approximately \$520,000. These actions further increased the deficit in the Tax Account.

[29] Garland says he believed TPC was entitled to use such funds in this manner, although he had no basis for this belief apart from his personal view that there would be no problem so long as he eventually replaced the funds. Garland did not consult legal counsel regarding TPC's legal position and obligations prior to the events giving rise to this litigation. Garland says he intended to replace the monies taken for such purposes with the proceeds of future sales of franchises. However, the downturn in the economy between late 2007 and 2009 further inhibited the sale of new franchises, with the result that these funds were never restored to the Tax Account.

The Overdraft Experience in the TPC Tax Account

[30] During the period 2003 to 2011, there were a total of approximately 100 occasions on which an overdraft remained at the end of a business day in the Tax Account. On most, if not all of these occasions, it is probable that a representative of the T-D bank contacted TPC, although there is no direct evidence of any such communications prior to November 2009 as described below. The written evidence in respect of contacts between T-D and TPC representatives commences in November 2009, when the T-D implemented a note-taking software programme that was used by its client service representatives. However, I am satisfied that the notes reflect a practice that existed throughout the period from 2003 onward. The evidence indicates that, in each case in which a representative of the T-D contacted TPC, the T-D was advised that the overdraft was due to a timing difference

between the payment and receipt of funds from employers that would be covered the following day.

[31] Garland acknowledges that a "handful" of calls, perhaps six or seven, from the T-D respecting overdrafts in the Tax Account were directed to him, although for the most part the calls were directed to his staff. In no case did TPC fail to cover the overdraft the following day out of payments received from other employers, although on a number of occasions a further overdraft arose which similarly had to be covered the following day.

[32] The evidence further reveals that the number and frequency of these overdrafts in the Tax Account increased commencing in 2007. Garland acknowledges that he was confused regarding the explanation for the overdrafts and that he "wasn't happy" with the timing explanations of his staff. He says he asked his daughter to investigate but she became caught up in the detail and could not give him a substantive answer.

[33] In addition, Garland acknowledges that, from time to time, TPN loaned monies to TPC for the purpose of covering overdrafts in the Tax Account. It appears that these loans were repaid. The most current loan of \$1 million was made in October 2010 and was repaid from the Tax Account on February 2, 2011, as discussed further below.

The Events Giving Rise to This Litigation

[34] On or about January 19, 2011, a representative of the T-D advised Garland by email that the Tax Account was in overdraft in the amount of approximately \$1.767 million. The T-D requested a meeting with Garland on January 24, 2011, and advised prior to such meeting that it would not permit any further overdrafts. The T-D understood at the time that further deposits into the Tax Account on January 20 and January 21, 2011 would eliminate the overdraft by the end of January 21, 2011. However, this did not occur.

[35] On or about January 20, 2011, Garland advised the T-D on behalf of TPC that TPC believed the overdraft was consistent with its experience in prior years early in the new year, when it had to advance funds to cover "year-end adjustment, bonus payments and EHT payments" before it received the funds from its clients to make such payments.

[36] On January 25, 2011, Garland met with representatives of the Loan Recovery Group of the commercial banking division of the T-D, including Karen Tyrrell who testified at trial with respect to this meeting and the involvement of the Loan Recovery Group. At that time, Garland did not understand, and was therefore unable to explain to the T-D, why the overdraft was so large and why it continued to exist.

[37] On January 21, 2011, Garland also met with a representative of BDO Canada Inc. ("BDO"). At the meeting on January 25, 2011, Garland agreed to have TPC engage BDO to conduct an investigation of TPC's affairs and report its findings to the parties. BDO was subsequently engaged pursuant to an engagement letter dated January 31, 2011 to conduct such an investigation.

[38] The investigation revealed that, on or about January 6, 2011, TPC transferred approximately \$2.3 million from the Tax Account to the CRA, which represented an

overpayment of approximately \$1.78 million. The CRA refused to return the excess payment. These circumstances created an overdraft of approximately \$70,000, which was soon reduced by other payments from the Payroll Account into the Tax Account in the course of TPC's usual business activities.

[39] Accordingly, as TPC continued to carry on business, monies were pushed into the Payroll Account and were transferred from the Payroll Account to the Tax Account. Payments were also made out of the Payroll Account to employees and out of the Tax Account to the Collecting Authorities in the ordinary course as such payments fell due.

[40] However, from January 10, 2011 forward, there was a negative balance in the Tax Account at the end of each banking day. Despite daily assurances to the T-D client service representative who called TPC regarding this situation, it is not clear that the overdraft was covered in the course of each of the following days. Rather, the overdraft appears to have persisted throughout the period to January 19, 2011 and beyond, although it fluctuated in amount.

[41] On January 28, 2011, the T-D reduced to zero the overdraft existing on that date, being \$1,040,284.43, by setting up this amount as a demand loan owing by TPC to the T-D. The T-D advised Garland that it would continue to permit TPC to operate but would not permit any further overdrafts in the Tax Account.

[42] On February 2, 2011, TPC transferred or paid \$1 million out of the Payroll Account to a similar payroll account maintained by TPN, by means of an on-line electronic funds transfer. Garland says that these monies represented repayment of a loan made from the TPN payroll account to TPC on October 15, 2010 that was used by TPC to cover a deficiency in the Tax Account at that time. Garland says that he had intended that the loan would be repaid as soon as funds were available.

[43] On February 10, 2011, Garland advised the T-D that TPC could no longer continue to carry on business as it lacked the necessary funds to eliminate the overdraft in the Tax Account and to fund its continuing operations. The T-D therefore froze the accounts of TPC. As of the close of business on February 9, 2011, the Payroll Account had a balance of \$2,518,210.79 while the Tax Account had a zero balance.

The BDO Report

[44] On February 11, 2011, BDO delivered its report in this matter summarizing the results of its investigation (the "Initial BDO Report").

[45] BDO identified all credits and debits to the Tax Account, and the corresponding account of TPN, from September 1, 2010 to January 31, 2011 and found both material and immaterial deviations.

[46] In particular, BDO identified an over-remittance of TPN on January 6, 2011 of \$503,356.66 and an over-remittance of TPC on the same date of \$1,693,879.24. This latter over-remittance caused the overdraft that set in motion the events giving rise to the litigation. BDO noted that this amount had been reduced by February 9, 2011 to approximately \$1.3

million after application of subsequent remittances due. BDO also noted a large number of unsupported debits from the Tax Account, including transfers to the Payroll Account to cover overdrawn balances, transfers to the Operating Account, and transfers to TPN.

[47] BDO calculated the overall shortfall in the Tax Account to be approximately \$2.4 million as at February 8, 2011, based on an aggregate liability to the Collecting Authorities of \$3.2 million plus the demand loan liability to the T-D of \$1.1 million, less cash on hand of \$550,000 and the over-remittance to the CRA as of that date of \$1.3 million (all such figures being approximate).

Subsequent Developments

[48] By order of Low J. dated June 28, 2011, the T-D interpleaded the funds in the Payroll Account at that time totaling \$2,397,786.75. The T-D makes no claim in respect of these funds.

[49] By order dated November 14, 2011, BDO Canada Limited was appointed the IFA. The IFA was ordered to pay the interpleaded funds, less its costs, to the claimants on a *pari passu ex post facto* basis. In this capacity, the IFA has issued five reports to the Court.

[50] The IFA has accepted claims from the claimants totaling \$5,098,381.52, representing the net amounts lost by the 416 claimants as a result of shortfalls in the TPC bank accounts. This amount was subsequently increased to \$5,113,744.64 as a result of a few adjustments. The IFA has received the interpleaded funds plus accrued interest, totalling \$2,443,669.47, of which \$2,112,773.63 has been distributed to the claimants. In addition, the claimants have been credited with a distribution from the CRA of \$445,038.69. The IFA has also received a further \$73,349.74 which is available for distribution. Accordingly, the total loss of the claimants is \$2,482,582.58.

Factual Determinations

[51] The following factual determinations regarding Garland and the T-D inform the conclusions reached below.

Factual Findings Regarding Garland

[52] First, Garland was aware that the monies in the Tax Account were not monies of TPC but rather of the franchisees' employer clients or their employees.

[53] Second, Garland was aware that TPC was obligated to return any monies that TPC paid out of the Tax Account to its Operating Account. As such, it necessarily follows that Garland was aware that TPC was acting in breach of trust in making such transfers, even if he did not express the obligation of TPC in such terms. This issue is addressed further below.

[54] Third, Garland was aware that the business operations of TPC were not profitable. This was clear from the annual financial statements of TPC.

[55] Fourth, Garland was aware from Flewelling that there was a possible deficit in the Tax Account from the time of his acquisition of TPC. I would also note that Garland also

implicitly acknowledged the existence of a deficit in his description of the Transaction, which he understood involved the assumption of obligations estimated to be between \$250,000 and \$300,000. As the opening financial statements of TPC, as of July 31, 2003, do not reflect any such obligations, the assumed obligations to which Garland refers must have pertained to a mismatch between outstanding receipts due from franchisee clients and outstanding payment obligations i.e. the deficit in the Tax Account. Garland was also aware of facts that would reasonably imply that this deficit was growing larger as a result of TPC's transfers of funds from the Tax Account to its Operating Account to fund its operating expenses, including its expenses of computerization.

[56] Fifth, when contacted by the T-D in respect of overdrafts in the Tax Account, representatives of TPC, including Garland on a number of occasions, explained the overdrafts as the product of a timing difference between the date of payment of client payrolls and the date of collection of the payroll monies from the clients' banks. Garland had no support for this conclusion.

[57] Sixth, TPC's business plan proceeded on the basis that any underlying deficit in the Tax Account would remain outstanding and would not need to be repaid in the normal course of its operations. Instead, TPC effectively relied on a combination of on-going payments into the Tax Account and continued access to the T-D electronic banking facilities, which required that any overdrafts be covered within twenty-four hours. Garland was aware that TPC's operations were being conducted on this basis.

Factual Findings Regarding the T-D

[58] First, the T-D was aware that the Payroll Account and the Tax Account were trust accounts. In particular, the Cash Management Group at the T-D was aware from prior experience with the business of Time Plus Canada Inc. under Haslem's ownership, and the establishment of the electronic banking facilities in favour of TPC, that the monies in these accounts did not belong to TPC and, as such, were trust funds. While it may well have been the case that the client service representatives of the T-D over the period 2003 to 2011, including Dave Copeland ("Copeland") and Eszter Egervari ("Egervari"), or members of the Loan Recovery Group, including Tyrell, did not have such an appreciation, the T-D is fixed with such knowledge from and after 2003 – that is, once representatives of the Cash Management Group at the T-D acquired this knowledge in respect of its on-going client, the T-D as an institution cannot have lost that knowledge because of its client relationship managers' more limited involvement and understanding of their client's business.

[59] Second, and on the other hand, the evidence does not support the conclusion that T-D had knowledge of the existence of the underlying deficit in the Tax Account. In particular, there is no evidence that the Cash Management Group at T-D had evidence of the deficit at the time of its involvement in the establishment of electronic banking facilities in favour of TPC in 2003. The T-D's willingness to continue providing these facilities in the face of overdrafts in the Tax Account was based on the explanation of the overdrafts provided to it by TPC representatives, including Garland, in the context of the 48-hour window for rejection of cheques under bank payment clearing rules.

[60] Third, the T-D also did not have any knowledge of the payments out of the Tax Account to TPC to fund its operations, including the cost of automating its system.

The Issues in this Action

[61] Notwithstanding the foregoing background to the present litigation, the plaintiffs do not assert any claims against Garland based on misrepresentations made to them. Instead, the plaintiffs assert two claims against the T-D which, in turn, also asserts claims against Garland.

[62] The specific issues in this action are the following:

1. The plaintiffs' claim against the T-D in the amount of \$1,327,616 for knowing receipt of trust monies;
2. The plaintiffs' claim against the T-D for knowing assistance in a breach of trust in respect of the \$1 million payment made by TPC from the Payroll Account to the TPN payroll account on February 2, 2011;
3. The T-D cross-claim against Garland for damages for fraud in the amount of \$1,040,284.43; and
4. The T-D cross-claim against Garland for contribution or indemnity in respect of any amounts required to be paid by the T-D to the plaintiffs.

I will discuss each of these issues in turn.

Knowing Receipt of Approximately \$1.3 Million

[63] The plaintiffs assert a claim of \$1,327,616 against the T-D for knowing receipt of trust funds, being funds pushed from the Payroll Account to the Tax Account on January 20, 2011 and January 21, 2011. These pushes had the effect of reducing the overdraft position in the Tax Account from approximately \$2.35 million to approximately \$1.04 million.

Applicable Law

[64] The principles pertaining to liability for "knowing receipt" were set out by LaForest J. in *Citadel General Assurance Co. v. Lloyds Bank Canada*, [1997] 3 S.C.R. 805, 152 D.L.R. (4th) 411 [*Citadel*]. LaForest J. identified two requirements: (i) demonstration that a stranger to a trust has received or applied trust property for its own use and benefit, rather than as agent of the trustees; and (ii) demonstration of actual knowledge of a misapplication of trust property or of a failure to inquire as to the possible misapplication of trust property having knowledge of facts which would put a reasonable person on inquiry.

[65] La Forest set out the nature of "knowing receipt" claim as follows, at para. 24:

... strangers to the trust who receive trust property for their own benefit and with knowledge that the property was transferred to them in breach of trust. In all cases it is immaterial whether the breach of trust was fraudulent; see

Halsbury's Laws of England (4th ed. 1995), vol. 48, at para. 595; Pettit, *supra*, at p. 168; *Underhill and Hayton, Law Relating to Trusts and Trustees* (14th ed. 1987), at p. 357. The second type of case, which is relevant to the present appeal, raises two main issues: the nature of the receipt of trust property and the degree of knowledge required of the stranger to the trust.

[66] With respect to the first requirement, LaForest J. specifically addressed the receipt requirement in the banking context, at paras. 25-26:

Liability on the basis of "knowing receipt" requires that strangers to the trust receive or apply trust property for their own use and benefit; see *Agip (Africa) Ltd. v. Jackson*, [1990] 1 Ch. 265, aff'd [1992] 4 All E.R. 451 (C.A.); *Halsbury's Laws of England*, *supra*, at paras. 595-96; Pettit, *supra*, at p. 168. As Iacobucci J. wrote in *Air Canada v. M & L Travel Ltd.*, *supra*, at pp. 810-11, the "knowing receipt" category of liability "requires the stranger to the trust to have received trust property in his or her personal capacity, rather than as an agent of the trustees". In the banking context, which is directly applicable to the present case, the definition of receipt has been applied as follows:

The essential characteristic of a recipient . . . is that he should have received the property for his own use and benefit. That is why neither the paying nor the collecting bank can normally be made liable as recipient. In paying or collecting money for a customer the bank acts only as his agent. It sets up no title of its own. It is otherwise, however, if the collecting bank uses the money to reduce or discharge the customer's overdraft. In doing so it receives the money for its own benefit...
[footnotes omitted].

Thus, a distinction is traditionally made between a bank receiving trust funds for its own benefit, in order to pay off a bank overdraft ("knowing receipt"), and a bank receiving and paying out trust funds merely as agent of the trustee ("knowing assistance"); see *Underhill and Hayton, supra*, at p. 361.

[67] With respect to the second requirement, LaForest J. approached the basis of the remedy as restitutionary with the result that a lesser knowledge requirement, which therefore includes constructive knowledge as well as actual knowledge, would suffice to fix a recipient of trust funds with the obligation to make restitution.

Position of the Plaintiffs

[68] The plaintiffs argue that both requirements of "knowing assistance" have been satisfied in the present circumstances.

[69] The plaintiffs argue that the T-D engaged in knowing receipt of funds and in particular, engaged in the knowing receipt of \$1,327,616 between January 19, 2011 and January 21, 2011. The plaintiffs argue that Copeland, as the T-D client service representative

for TPC, and the members of the Cash Management Group who dealt with TPC, knew that the monies in the Tax Account were trust monies by virtue of their knowledge of the business of TPC. The plaintiffs argue that the occurrence of overdrafts as early as 2003 was sufficient to subject the T-D to an obligation to inquire as to the reason for the overdrafts. Alternatively, they argue that the T-D was fixed with such an obligation to inquire as to the reason for the overdrafts no later than November 17, 2009, when Copeland knew that \$957,898.85, which was used to cover a very large overdraft in the Tax Account, was transferred from TPN. I note, however, that, with respect to this transaction, the evidence indicates only that the T-D was advised that funds from a related party would be paid into the Tax Account to cover the deficit existing at that time. As a third alternative, the plaintiffs submit that the increased number of overdrafts, and the generally increasing size of such overdrafts, in the period 2007 to 2011 required the T-D to inquire into the reason for the overdrafts.

Analysis and Conclusion

[70] For the following reasons, I conclude that the plaintiffs have not demonstrated either requirement of "knowing receipt" of trust monies on the part of T-D for the purposes of this claim.

[71] First, I do not think that the facts known to the T-D regarding the business of TPC imposed a duty on the T-D to inquire into the source of the overdrafts in the Tax Account.

[72] The T-D acknowledges that it had knowledge of the business of TPC from 2003 onward by virtue of the involvement of the Cash Management Group in the establishment of electronic banking facilities for TPC at the time of the Transaction. Such knowledge would necessarily have included the fact that the Payroll Account and the Tax Account were trust accounts holding monies belonging to TPC's clients. As mentioned, whether or not Copeland and later Egervari, as the T-D client service representatives for TPC, also had such information is not relevant. Once fixed as an institution with such knowledge, the T-D cannot lose such knowledge by virtue of an internal failure or lack of communication.

[73] However, the T-D's knowledge of TPC's business did not include knowledge that Time Canada Plus Inc. was running a deficit at the time of the Transaction that was assumed by TPC. The suggestion that Flewelling had such knowledge while still an employee of the T-D has not been established. In fact, the plaintiffs implicitly acknowledge such fact by arguing that the T-D became subject to a duty to inquire into the source of the overdrafts at some point in time subsequent to the Transaction. Moreover, because TPC did not request any credit facilities, TPC had no reporting obligations to the T-D. As a result, TPC was not obligated to deliver financial statements to the T-D that would have demonstrated TPC's lack of profitability or that otherwise might have put the T-D on notice of the existence of a deficit.

[74] The issue therefore turns on whether the continuing existence of the overdrafts, the pattern of increasing numbers of overdrafts in larger amounts, and the advice that the overdrafts were, in part being covered by transfers of funds from related parties, taken together, triggered a duty to inquire. I do not think they did.

[75] Critically, there is no evidence that, prior to January, 2011, TPC failed to cover any of the overdrafts within the 48-hour period within which, according to bank payment clearing rules, the T-D could reject and return cheques which placed the Tax Account in an overdraft position *vis-à-vis* the T-D, i.e. that involved the extension of an involuntary unsecured loan by the T-D to TPC. In these circumstances, I do not think that the principles of the tort of "knowing receipt", as applied in the banking context, imposed a duty to inquire on the T-D. The plaintiffs have not provided the Court with any case law in which a duty to inquire was imposed in similar circumstances.

[76] Further, the T-D did inquire every time a non-eligible overdraft arose. On each occasion, it appears that the T-D was given the explanation of a timing difference between the date of payment and the date of collection of monies from the franchisees' clients in respect of such payments. Given the absence of any knowledge on the part of the T-D of the existence of an underlying deficit in the Tax Account or of TPC's use of Tax Account funds for its own purposes, there was no basis for further inquiry on the part of T-D, particularly given the fact that TPC always covered the overdraft the following day. Nor was there a basis on which the T-D could reasonably reject TPC's explanation.

[77] In addition, and in any event, I do not think that the plaintiffs have established the other requirement of the tort of "knowing receipt" – that the T-D applied trust monies for its own benefit between January 19 and 21, 2011, or at any time prior to the termination of TPC's banking facilities.

[78] At all times, the transfers of monies into the Payroll Account, and from the Payroll Account into the Tax Account, operated in the normal course of TPC's collection and disbursement operations in accordance with the instructions of TPC. The T-D did not take any action on its part that constituted the application of monies to reduce the overdraft which arose in January, 2011.

[79] As I understand the facts, TPC continued throughout January and early February to pull funds from its clients and to push funds out of the Payroll Account to employee accounts and, until January 21, 2011, to the Tax Account on account of future remittances. If the tax remittances had been due immediately, there would have been no reduction in the overdraft. Because they were not, the overdraft was reduced but not because of any independent action on part of the T-D.

[80] In short, the pushes of funds out of the Payroll Account and into the Tax Account were part of the ordinary day-to-day activities of TPC. These transactions were part of the T-D's activities as a collecting bank for TPC which, as La Forest J. addressed above, do not constitute "receipt" for purposes of the tort of "knowing receipt".

[81] These circumstances are distinguishable from the cases of "knowing receipt" cited to the Court. For example, in *Citadel*, the bank transferred monies held in trust for the insurer to the account of another party whose account was in overdraft with the bank. By contrast, in this case, the monies would not have reduced any amount of an overdraft and would, instead, have remained in the Tax Account in trust for the clients of TPC and their employees until payment was made to the Collecting Authorities, but for the existence of a

deficit which gave rise to an overdraft and, ultimately, to T-D's involuntary extension of credit.

[82] Based on the foregoing, the plaintiffs' claim of "knowing receipt" is dismissed.

Knowing Assistance in Respect of a \$1 Million Payment

[83] The plaintiffs also assert a claim of \$1 million against the T-D for knowing assistance in a breach of trust, being the payment of \$1 million on February 2, 2011 from the Payroll Account to the TPN payroll account. In the course of the trial, the plaintiffs settled with Garland in respect of the related claim against him for breach of trust on the basis of Garland's consent to a judgment against him in the amount of \$1 million.

Applicable Law

[84] The principles pertaining to "knowing assistance" in a breach of trust were set out by Iacobucci J. in *Air Canada v. M&L Travel Ltd.*, [1993] 3 S.C.R. 787 at paras. 34, 37, 38, 40 and 59, 108 D.L.R. (4th) 592 [*Air Canada*]:

... strangers to the trust can also be personally liable for breach of trust if they knowingly participate in a breach of trust. The starting point for a review of the bases of this kind of personal liability is *Barnes v. Addy*...

...in *Barnes v. Addy, supra*, at p. 252, Lord Selborne L.C. stated that persons who "assist with knowledge in a dishonest and fraudulent design on the part of the trustees" will be liable for the breach of trust as constructive trustees. See also, *Soar v. Ashwell*, [1893] 2 Q.B. 390 (C.A.). This basis of liability raises two main issues: the nature of the breach of trust and the degree of knowledge required of the stranger.

(a) Degree of Knowledge of the Stranger

The latter point may be quickly addressed. The knowledge requirement for this type of liability is actual knowledge; recklessness or wilful blindness will also suffice. See *Belmont Finance, supra*, at pp. 130, 136; *In re Montagu's Settlement Trusts, supra*, at pp. 271-72, 285; *Carl-Zeiss-Stiftung v. Herbert Smith & Co. (No. 2)*, [1969] 2 All E.R. 367 (C.A.), at p. 379. In the latter case, Sachs L.J. stated that to be held liable the stranger must have had "both actual knowledge of the trust's existence and actual knowledge that what is being done is improperly in breach of that trust -- though, of course, in both cases a person wilfully shutting his eyes to the obvious is in no different position than if he had kept them open." Whether the trust is created by statute or by contract may have an impact on the question of the stranger's knowledge of the trust. If the trust was imposed by statute, then he or she will be deemed to have known of it. If the trust was contractually created, then whether the stranger knew of the trust will depend on his or her familiarity or involvement with the contract.

...

The reason for excluding constructive knowledge (that is, knowledge of circumstances which would indicate the facts to an honest person, or knowledge of facts which would put an honest person on inquiry) was discussed in *In re Montagu's Settlement Trusts*, supra, at pp. 271-73, 275-85. Megarry V.-C. held, at p. 285, that constructive notice was insufficient to bind the stranger's conscience so as to give rise to personal liability. While cases involving recklessness or wilful blindness indicate a "want of probity which justifies imposing a constructive trust", Megarry V.-C., at p. 285, held that the carelessness involved in constructive knowledge cases will not normally amount to a want of probity, and will therefore be insufficient to bind the stranger's conscience.

...in my view, the standard adopted by Peter Gibson J. in the *Baden, Delyvaux* case, following the decision of the English Court of Appeal in *Belmont Finance*, supra, is a helpful one. I would therefore "take as a relevant description of fraud 'the taking of a risk to the prejudice of another's rights, which risk is known to be one which there is no right to take'." In my opinion, this standard best accords with the basic rationale for the imposition of personal liability on a stranger to a trust which was enunciated in *In re Montagu's Settlement Trusts*, supra, namely, whether the stranger's conscience is sufficiently affected to justify the imposition of personal liability. In that respect, the taking of a knowingly wrongful risk resulting in prejudice to the beneficiary is sufficient to ground personal liability.

[85] For the purposes of this claim and the claim of deceit addressed below, the definition of "recklessness" is important. "Recklessness" is defined in *Black's Law Dictionary* (7th Ed.) (St. Paul, Minn., 1999) in the following terms:

1. Conduct whereby the actor does not desire harmful consequence but nonetheless foresees the possibility and consciously takes the risk. Recklessness involves a greater degree of fault than negligence but a lesser degree of fault than intentional wrongdoing.
2. The state of mind in which a person does not care about the consequences of his or her actions.

The Issue Before the Court

[86] I do not think it can be disputed that the TPC payment of \$1 million on February 2, 2011 from the Payroll Account to the payroll account of TPN constituted a breach of trust. Such payment was made for the benefit of TPC by way of a repayment of an earlier loan, made on October 15, 2010, from the TPN tax account to TPC which, in turn, paid the money into the Tax Account to cover an existing overdraft. Monies in the Payroll Account were held in trust for the franchisees' employer clients pending the payment of salaries and wages. While the original loan from the TPN tax account may also have constituted a breach of trust in respect of that tax account, that is not relevant for present purposes. There is also no doubt

from the evidence that Garland, in his capacity as the controlling mind and will of TPC, caused TPC to make this payment.

Position of the Plaintiffs

[87] The plaintiffs say that from and after the meeting on January 25, 2011, the T-D had notice not only of the possibility of a significant underlying deficit in the Tax Account, but also of the possibility that the source of the overdraft at that time might have been fraudulent actions on the part of TPC, and in particular of Garland as the controlling mind and will of TPC. They say that the T-D should have monitored the operations of TPC from that day forward, including payments out of the Payroll Account, and should have inquired into this particular payment, which would have resulted in a reversal. They argue that the failure of the T-D to take such steps constituted wilful blindness or recklessness in regard to a possible breach of trust.

Position of the T-D

[88] The T-D says that the \$1 million transfer was an electronic funds transfer initiated by TPC and that it had no authority to reverse the transaction once it had occurred. It says the only way it could have prevented the transaction was to freeze the Payroll Account, which would have shut down TPC's business and resulted in prejudice to TPC's clients, including the plaintiffs. It says that it was awaiting the BDO Initial Report and, in the meantime, was trying to allow TPC to survive.

Analysis and Conclusions

[89] The requirements for liability for knowing assistance or knowing participation in a breach of trust are: (1) a breach of trust by one or more trustees; and (2) knowing participation in the breach of trust by a third party. In my view, both requirements are satisfied in the present circumstances for the following reasons, dealing with the requirements in order.

[90] First, there is no question that a breach of trust occurred on the payment from the Payroll Account. This was a deliberate act on the part of Garland as the controlling mind and will of TPC. This satisfies the narrower requirement expressed in a line of cases referred to by Iacobucci J. in *Air Canada* that the breach of trust be "fraudulent and dishonest" as these terms are understood in this context.

[91] Second, as a factual matter, there is also no issue that the T-D participated in the breach of trust by continuing to grant access to its electronic banking services to TPC, by which the transfer was effected.

[92] The central issue is therefore whether T-D's knowledge at the time satisfied the knowledge requirement for "knowing assistance".

[93] By February 2, 2011, the T-D was aware that a significant deficit existed in the Tax Account. It had already converted the amount of \$1,040,284.43 into an unsecured demand loan of TPC on its books, which, in effect, recognized the existence of a deficit. As discussed above, T-D was also aware that the Payroll Account as well as the Tax Account

were trust accounts. It may be that members of the Loan Recovery Group of the T-D were not personally aware of the trust nature of the Payroll Account. However, for present purposes, as discussed above, the Court must proceed on the basis that the T-D institutionally had such knowledge. Moreover, the T-D had advised TPC that it would only permit the Tax Account to continue to operate on the basis of funds in hand. More significantly, after the meeting with Garland on January 25, 2011, the T-D's counsel referred to Garland's own concern for the possibility of fraud in the account as an explanation for the large overdraft. In addition, the parties had agreed to the engagement of BDO to investigate the origin of the overdraft.

[94] Accordingly, the T-D had clear notice of a real possibility of past actions constituting a breach of trust in respect of the operations of TPC, possibly extending to fraud, by an unknown party. There was no reason to believe that further such actions, whatever they might be, could not occur in the future. In such circumstances, I think the T-D had an obligation to monitor transactions out of the Payroll Account to ensure that improper transactions did not re-occur.

[95] While the T-D was commendably attempting to allow TPC to survive pending receipt of the BDO Initial Report regarding its investigation, it has not established that imposition of a monitoring requirement would have prevented TPC from continuing its business on the basis stipulated by the T-D. The T-D suggests that it had no ability to monitor electronic funds transfer transactions. However, it is not credible that the T-D could not have put in place some form of pre-approval or other form of pre-transaction monitoring that would have identified the proposed transaction.

[96] In such circumstances, I conclude it was reckless of the T-D to allow TPC continued access to its electronic funds transfer facilities on an unmonitored basis in respect of the Payroll Account. Pending receipt of the BDO Initial Report of its investigation, which both the T-D and Garland considered imperative, there was a real possibility that transactions involving a breach of trust would be identified in the Report. There was therefore a similar risk that further transactions involving a breach of trust could occur. The fact that the actual transaction on February 2, 2011 might have been different from that anticipated after the meeting of January 25, 2011 is irrelevant.

[97] Based on the foregoing, the plaintiffs are entitled to judgment in their favour in the amount of \$1 million against the T-D for knowing assistance in the breach of trust constituted by the payment of \$1 million on February 2, 2011 from the Payroll Account to the TPN payroll account.

The T-D Claim Against Garland

[98] The T-D seeks judgment against Garland on the grounds of deceit or fraudulent misrepresentation in the amount of \$1,040,284.43, being the amount of the overdraft in the Tax Account set up as an unsecured loan on January 28, 2011.

Applicable Law

[99] Civil fraud is embraced within the tort of deceit. The nature of civil fraud was addressed by Lord Herschell in *Derry v. Peak* (1889), 14 App. Cas. 337 (H.L.) at pp. 374-376 [*Derry v. Peak*]. I have cited an extended excerpt as it is relevant for the present issue, particularly the italicized passages below dealing with the knowledge requirement for this tort:

Having now drawn attention, I believe, to all the cases having a material bearing upon the question under consideration, I proceed to state briefly the conclusions to which I have been led. I think the authorities establish the following propositions: First, in order to sustain an action of deceit, there must be proof of fraud, and nothing short of that will suffice. Secondly, fraud is proved when it is shown that a false representation has been made (1) knowingly, or (2) without belief in its truth, or (3) recklessly, careless whether it be true or false. Although I have treated the second and third as distinct cases, I think the third is but an instance of the second, for one who makes a statement under such circumstances can have no real belief in the truth of what he states. To prevent a false statement being fraudulent there must, I think, always be an honest belief in its truth and this probably covers the whole ground, for one who knowingly alleges that which is false, has obviously no such honest belief. Thirdly, if fraud be proved, the motive of the person guilty of it is immaterial. It matters not that there was no intention to cheat or injure the person to whom the statement was made.

...
In my opinion making a false statement through want of care falls far short of, and is a very different thing from, fraud, and the same may be said of a false representation honestly believed though on insufficient grounds. Indeed Cotton L.J. himself indicated in the words I have already quoted, that he should not call it fraud. But the whole current of authorities, with which I have so long detained your Lordships, shews to my mind conclusively that fraud is essential to found an action of deceit, and that it cannot be maintained where the acts proved cannot properly be so termed.

...
At the same time I desire to say distinctly that when a false statement has been made the questions whether there were reasonable grounds for believing it, and what were the means of knowledge in the possession of the person making it, are most weighty matters for consideration. *The ground upon which an alleged belief was founded is a most important test of its reality. I can conceive many cases where the fact that an alleged belief was destitute of all reasonable foundation would suffice of itself to convince the Court that it was not really entertained, and that the representation was a fraudulent one.* So, too, although means of knowledge are, as was pointed

out by Lord Blackburn in *Brownlie v. Campbell* [5 App. Cas. at p. 952], a very different thing from knowledge, *if I thought that a person making a false statement had shut his eyes to the facts, or purposely abstained from inquiring into them, I should hold that honest belief was absent, and that he was just a fraudulent as if he had knowingly stated that which was false.* [Italics added.]

[100] Non-disclosure of material facts can amount to fraud if, among other things, the non-disclosure constitutes a fraudulent misrepresentation. This has been addressed in *Perdue v. Myers*, [2005] O.J. No. 3637 at para. 31 (S.C.), 2005 CarswellOnt 3981 [*Perdue v. Myers*] as follows:

Silence can be taken as fraudulent misrepresentation. The circumstances must establish dishonest conduct on the part of the defendant, who must have intended (i) to deceive the plaintiff by his/her failure to disclose irrelevant [sic] information, and (ii) to commit a fraudulent act by such non disclosure equivalent to that which would prevail had he/she made a false statement knowing it to be false. See: *411397 B.C. Limited v. Granmour Holdings Limited* [1996] B.C.J. No. 1310 (S.C.).

Position of the T-D

[101] The T-D argues that, over the eight-year period of TPC's operations, Garland represented to the T-D, directly or indirectly, that the overdrafts in the Tax Account were the result of timing differences between collection and payment of monies in the Tax Account. The T-D says that Garland knew that the representations made to the T-D regarding the reason for the overdrafts were incorrect. In particular, it says that Garland acknowledged and admitted to causing TPC to take monies out of the Tax Account to fund its operations. On this basis, it says the facts support a claim of deceit against Garland.

Position of Garland

[102] TPC acknowledges that it is liable to the T-D for the amount advanced as a demand loan to cover the overdraft in the Tax Account on January 28, 2011. It can hardly do otherwise as the T-D involuntarily advanced funds on behalf of TPC to honour cheques drawn by it on the Tax Account.

[103] However, Garland denies that such funds were obtained by actions constituting civil fraud or deceit. He says that the T-D has failed to establish the elements of deceit. In particular, Garland says that the T-D has failed to demonstrate any false representations of the defendants that were made to the T-D with the intention of inducing the T-D to lend money to it. Garland also says that he personally never made any false or misleading statements to the T-D or provided any false or misleading documents to the T-D.

[104] More generally, it is Garland's position that he was negligent but did not act fraudulently. He says that it was difficult to manage and reconcile the constant flow of funds into and out of the Payroll Account, the Tax Account and the Operating Account, given the high volume of transactions which he estimates at approximately 600,000 per year.

[105] Garland says he was never told that the monies in the Tax Account were trust funds and did not have any concept or understanding of what was meant by reference to trust funds. He says he was misled by the T-D's actions in allowing TPC to maintain an overdraft position on a regular basis without rejecting any payments causing an overdraft position. He says that if he had been told that the monies in the Tax Account were trust funds and that any overdraft should not be tolerated, TPC would have either requested an operating loan from the T-D, sought the introduction of new funds, or ceased operations altogether.

Analysis and Conclusions

[106] I propose to address the extent to which each of the requirements of deceit have been established after first setting out certain preliminary observations that inform my approach to this claim and after considering two additional submissions of TPC and Garland whose determination is also relevant to the principal claim of deceit.

Preliminary Observations

[107] The following seven observations regarding the operations of TPC inform the conclusions reached below.

[108] First, Garland does not seriously dispute the characterization of the Tax Account as a trust account. He says however that he was not aware that this account was a trust account during the time that TPC carried on its operations. As mentioned above, while I accept that he may not have been told that the Tax Account was a trust account, I do not accept that he did not understand his obligations in respect of the monies in the Tax Account.

[109] The Tax Account monies were segregated from the monies and other assets of TPC. Among other things, this was clear from the TPC financial statements which did not include these monies. Moreover, Garland acknowledged that he understood that TPC had to repay the monies transferred from the Tax Account to TPC for its corporate purposes. These facts are sufficient to establish that Garland understood that these monies were trust monies even if he did know the legal nomenclature.

[110] Second, Garland learned that there was a possibility of an underlying deficit in the Tax Account at some point during the first year after the Transaction. As mentioned, I think he also would have known that a deficit existed from his understanding that the Transaction involved an assumption of liabilities that were not reflected in the opening financial statements of TPC. I accept that any such deficit arose during Haslem's previous operation of the business of TPC and therefore was not attributable to Garland's actions, although if he had conducted any due diligence he might have identified the issue prior to completion of the Transaction. However, the historical attribution of the deficit is irrelevant. What is relevant is the situation in which Garland was placed after being fixed with this knowledge.

[111] The existence of a deficit entailed an excess of liabilities over assets in the Tax Account. In other words, TPC was unable to satisfy all the obligations for which it had received monies from third parties. In such circumstances, in my opinion, Garland had two options if he wished to avoid the risk of legal liability – quantify and eliminate the deficit by

additional funding of the Tax Account, if he wished to continue to operate the business of TPC, or cease the operations of TPC.

[112] Instead, Garland chose to carry on the TPC business, apparently in the expectation that the T-D would continue to allow access to its facilities provided overdrafts in the Tax Account were covered within twenty-four hours, and the further expectation that any overdraft would be so covered in the ordinary course of TPC's business. Effectively, Garland chose to carry on business on the assumption that the deficit would never exceed the anticipated receipts from other clients within twenty-four hours.

[113] In these circumstances, I observe there is a good argument that TPC was continuously misrepresenting to its clients that it was segregating and paying the monies necessary to discharge the obligations of its clients and their employees in a manner that would insulate those parties from the consequences of any failure or termination of operations of TPC. This representation is implied by, among other things, the language of the third recital in the standard form TPC client services agreement, which contemplates that TPC will direct client payments to a trust to be established with a Canadian chartered bank. Such a recital is meaningless unless it conveys an intention to ensure that the assets in the trust account will be sufficient to cover all liabilities of the TPC clients and their employees. Given that TPC created this document for its franchisees' clients, it is inconceivable that Garland would not have seen it at some point. Even without such language, however, Garland was aware that TPC was segregating the monies for tax remittances. It is a reasonable inference that he understood that the franchisees, and by extension their clients, would also know of these arrangements and were relying on them. Accordingly, I conclude that, as the guiding mind of TPC, Garland participated in any misrepresentations to the TPC clients. The claimants are not, however, making any claim against Garland for any such misrepresentations in this action.

[114] Third, it is not a defence for Garland to assert that he did not know with certainty of the existence of the underlying deficit or that he did not know the quantum of the deficit.

[115] Although it is possible that Flewelling told Garland that a deficit existed, it is sufficient for present purposes that, at a minimum, Flewelling told Garland that there was a possibility that a deficit existed. With such information, he was put on notice that continued operation of TPC's business would entail a risk of default in some manner if the quantum of the deficit, if any, were not determined and eliminated. Further, the fact that Garland's daughter was unable to quantify the amount of the deficit is no answer.

[116] Fourth, having been put on notice of the existence of a deficit, Garland caused TPC to increase the size of that deficit by transfers from the Tax Account that he estimates averaged \$65,000 per year, for a total of approximately \$520,000. Even if there had been no prior deficit, such actions created a risk that TPC would not be able to cover its liabilities at some time in the future. Moreover, as a practical matter, these continuing transfers increased the likelihood of an overdraft that could not be covered within twenty-four hours by further "pulls" from other TPC clients. The larger the deficit, the greater the likelihood of such an overdraft that could lead to the shutdown of the T-D electronic banking facilities and TPC's operations, leaving unpaid liabilities outstanding.

[117] Fifth, in effect, TPC looked to the assets of its clients to fund its operations. The unaudited financial statements of TPC reveal that its only profitable year was the year ended July 31, 2010. Garland caused TPC to transfer monies from the Tax Account to the General Account in order to provide TPC with a source of funding that avoided his need to put further monies into an unprofitable business.

[118] Sixth, the fact that the overdraft that triggered the demise of TPC occurred as a result of a clerical error of an unusually large magnitude that could not be reversed because of the position of the CRA is irrelevant for the liability issues in this proceeding. On its own, the clerical error created a liability that declined as it was applied against subsequent remittances. The evidence does not permit the Court to conclude that TPC could have covered the overdraft if the deficit did not also exist, although it suggests that TPC ought to have been able to do so by a short-term loan or otherwise. The evidence does, however, establish that the existence of the large deficit together with this clerical error resulted in TPC's inability to cover the overdraft out of subsequent "pulls" from TPC clients.

[119] Lastly, taking into account the foregoing, under Garland's direction, TPC ran a number of significant risks over the period of its operations itemized below. Garland was an experienced businessman. I am satisfied that Garland was sufficiently knowledgeable and experienced to recognize that the following actions ran the risk of a default by TPC in the payment of its obligations, including its obligations to the Collecting Authorities out of funds in the Tax Account.

[120] First, and fundamentally, Garland says that he did not have a good knowledge of the day-to-day operations of TPC notwithstanding that he was the president and effective chief operating officer of TPC and TPN and, more importantly, that the business of TPC and TPN involved responsibility for other people's money. To the extent this is true, Garland acted in a manner that was classically reckless in the sense that he acted with knowledge that he did not know, and did not reasonably attempt to understand, the risks to which the business was exposed, including the more specific risks described below of which he had more particular knowledge.

[121] Second, as mentioned Flewelling made Garland aware that there was a possibility of a deficit in the Tax Account. As an experienced businessman, he would have realized that this implied the possibility of a default if the operations of TPC terminated or slowed significantly. Nevertheless, he caused TPC to continue to carry on business without quantifying the amount of the deficit and without obtaining additional monies to eliminate any deficit that was found to exist.

[122] Third, as Garland himself admits, he caused TPC to transfer funds from the Tax Account to the Operating Account to cover TPC's own obligations. Garland acknowledged that TPC had an obligation to replace the monies taken from the Tax Account. However, he had no certainty that this would occur when he caused TPC to make such transfers and, as he knew, the monies were never repaid. Rather, he optimistically counted on events which did not occur, in particular, his ability to sell additional franchises.

[123] Fourth, in addition to the mounting deficit that would necessarily have arisen as a consequence of the foregoing circumstances, Garland was also aware from the annual financial statements that TPC was not profitable. However, he never contemplated an analysis of TPC's financial position to assure himself that these losses, which inevitably drained cash from TPC, were sustainable. Moreover, he regularly caused TPC to pay management fees for his services, which increased the operational loss and cash drain. Essentially, he appears to have assumed that the losses would be reversed and that TPC could survive on some basis until that time.

[124] Lastly, instead of attempting to understand the realities of the cash flows into the Payroll Account and the Tax Account, as TPC's needs increased, Garland chose to cause TPN to lend monies from similar accounts to TPC and to rely, without any basis in the banking arrangements with the T-D, on a continued grace period of twenty-four hours to cover overdrafts. To an experienced businessman, this need to cover cash flow deficiencies with external funding would be a red flag that there was a mismatch that needed to be investigated. However, Garland chose to continue the practice and did not investigate the source of the cash flow requirements further.

Promissory Estoppel

[125] Garland argues that by waiving its rights to refuse a payment approximately 100 times when there was an overdraft in the Tax Account, the T-D was estopped from claiming it was misled by the defendants and was further estopped from refusing payment when there were insufficient funds in the TPC Tax Account.

[126] I do not agree. Whatever Garland says he believed, there is no evidence that the T-D waived its right to refuse payment of an overdraft that was not covered within two business days. In other words, there is no evidence that the T-D ever departed from its practice of protecting its recourse under bank payment clearing rules to reverse a payment for insufficient funds within the period allowed under such rules. I would add that the fact that the language of certain banking documentation between TPC and the T-D may be interpreted to provide for an even tighter right on the part of the T-D is irrelevant.

[127] The defendants also say that the T-D allowed one-day overdrafts and, in the absence of any caution to the defendants, thereby lead the defendants to believe that such overdrafts were permitted and that T-D was satisfied with TPC's operations. There is no evidence whatsoever for this assertion. On each occasion on which there was a non-negligible overdraft, the T-D called TPC and required repayment within one day. Such communications entailed a caution, although no caution was required to preserve the T-D's legal rights. Insofar as any internal approval was involved at the T-D as a result of the size of the overdraft, the issue for the T-D appears to have been whether the overdraft was a cause for a concern that should result in a withdrawal of services or a requirement for a lengthened payment cycle, which TPC resisted. Further, Garland could not reasonably regard the T-D's actions as giving rise to an overdraft loan given the T-D's insistence on immediate coverage of any overdrafts. In addition, Garland was aware that TPC had never requested, and the T-D had never granted, any operating line of credit in respect of any overdrafts in the Payroll Account or the Tax Account. Nor had TPC or Garland ever given security to the T-D for any

such operating line. In such circumstances, it was unreasonable to conclude that the T-D was prepared to permit overdrafts.

Volenti Non Fit Injuria

[128] Garland says that the T-D permitted the overdrafts to occur on a regular basis in order to earn its fees on a high volume of transactions as well as overdraft fees. He argues that, in doing so, the T-D accepted the risk that TPC would not repay the overdrafts at some point and that, in such event, it would have no recourse to any guarantees of Garland. In other words, he says that the T-D advanced overdraft loans to TPC and assumed the risk of loss if the overdrafts were not repaid. Garland says that the principle of *volenti non fit injuria* applies in this case – that is, the plaintiffs knew the risk of advancing overdraft loans and assumed those risks for business reasons.

[129] As a preliminary matter, I note that *volenti non fit injuria* is a principle that is typically applied in tort actions involving physical injury. I am not aware of any case in which it has been applied in respect of an action for deceit or fraudulent misrepresentation. None of the authorities cited by Garland provide any assistance on this issue. I also agree with the T-D that, in the particular context of a claim for civil fraud, it is unreasonable to find that a party has consented to fraudulent actions.

[130] In any event, I think this defence also fails for a different reason that is specific to the facts of this case. Garland's argument proceeds on the basis that, in allowing TPC twenty-four hours to cover an overdraft, the T-D was extending a loan to TPC, the risk of repayment of which it was assuming. However, as mentioned above, the T-D did not make any such loans or assume such risk of repayment. The T-D proceeded at all times on the basis that it required repayment before expiry of the period within which, under bank payment clearing rules, it had recourse to its right to reject any payment for insufficient funds.

The Claim of Deceit

[131] I turn then to the requirements of deceit.

[132] The T-D has established the first requirement of a false statement of a material fact – namely, the explanation for the overdrafts of timing differences that was given on numerous occasions. The evidence establishes, and Garland acknowledges, that this statement was incorrect. The correct explanation was that the overdrafts resulted from an underlying deficit in the Tax Account, i.e. an excess of liabilities over assets that existed from the time of Garland's purchase of the Business in the Transaction and was enlarged by Garland's actions in causing TPC to pay monies from the Tax Account to the Operating Account to fund TPC's activities.

[133] TPC acknowledges that its employees made such representations to the Bank. However, Garland denies that he ever made any such representation to the T-D. I do not accept this for two reasons.

[134] First, there is evidence in the notations of the T-D client service representatives who used the T-D note-taking software programme, that, on at least one occasion, the representatives spoke to the TPC owner about an overdraft and received this explanation. Garland himself acknowledges receiving a handful of calls on the subject. It is inconceivable that he would not have given the standard explanation in such circumstances, particularly as there is no evidence that the T-D client service representatives were ever prepared to accept no explanation for an overdraft, or that they ever received any different explanation for an overdraft from Garland.

[135] In addition, and in any event, Garland was the controlling mind and will of TPC. He cannot shield himself from liability by alleging that the false explanation for the overdrafts was given by employees only. He was aware that the T-D would call in the event of an overdraft. He was aware of the explanation given by the TPC employees on the occasions when they did call. He was in a position to correct the explanation and did not do so. His silence in these circumstances constitutes the making of the representations to the T-D.

[136] The T-D has also satisfied the second requirement of an action for deceit by demonstrating that it has suffered damage. The T-D honoured payments that have resulted in an uncollectible loan against TPC in the amount of \$1,040,284.43.

[137] There is also no issue that the false representations caused the loss suffered by the T-D. If the T-D had been apprised of the true reason for the deficits, there is no doubt that it would not have continued to provide the electronic banking facilities to TPC that it did. I am satisfied that, as a condition of continued access to its electronic banking facilities, the T-D would have required evidence that the deficit in the Tax Account, which constituted a continuing breach of trust, was covered or eliminated, as well as protection against any recurrence.

[138] On the strength of the continuing false representations, the T-D continued to allow TPC access to these facilities. This ultimately resulted in the payment of an amount that created an overdraft that could not be covered by future pulls and pushes into the Tax Account. As mentioned, it is irrelevant that the particular payment that triggered the unmanageable overdraft was the result of a clerical error that was unrelated to the circumstances that created the deficit. As discussed above, given the existence of the large underlying deficit, there was no possibility of covering the overdraft resulting from the clerical error by subsequent pulls. In this sense, the false representations directly contributed to or caused the loss suffered by the T-D.

[139] The most difficult issue in this action is therefore the fourth requirement for deceit - whether the plaintiffs have established that the representation was made with the requisite level of knowledge. With respect to the TPC employees, there is no evidence of any intention to deceive the T-D, although the explanation given by them to the T-D for the overdrafts was incorrect. On the part of Garland, however, the facts are more complex.

[140] I have considerable sympathy for Garland's position. I do not think that Garland knowingly made any false statement directly to the T-D. I am also certain that he never

intended the loss that the T-D suffered, or that the TPC clients would have suffered if their loss had not been borne by the T-D. As his counsel mentions, he has had a long and successful business career without any suggestion of wrongdoing and he wishes to avoid any such finding at the end of his career. He believes that he acted honourably in his dealings with the T-D. Moreover, the original source of the deficit appears to have pre-dated the Transaction, and his considerable efforts to put the business on a more solid footing were thwarted by events largely beyond his control. Further, there is no evidence to support the T-D's allegation, made earlier in this litigation, that Garland diverted monies from TPC, or from the Tax Account, to Garland's family trusts. The only funds paid to or for his benefit on the record before the Court are the management fees paid to Desom in respect of services rendered to TPC.

[141] The issue in this action is, however, whether Garland made, or acquiesced in, the explanation to the T-D for the overdrafts "recklessly, careless whether it be true or false". Using the language in the definition of "recklessness" from *Black's Law Dictionary*, above, did Garland engage in conduct whereby, although he did not desire harmful consequences, he nonetheless foresaw the possibility and consciously took the risk? This is admittedly a very close question.

[142] Garland's position is that TPC did in fact run significant risks but that he, personally, was not aware that TPC was doing so. He also says that he relied entirely on his staff for the explanation given to the T-D regarding the overdrafts and, because of his limited knowledge of TPC's financial circumstances and the risks it was running, he was not aware of the actual underlying cause of the overdrafts, being the existence of a sizeable and growing deficit. While Garland may consider this to be an accurate description of his state of knowledge, however, I think that it does not accurately capture the extent of his knowledge, and his actual state of mind, in this case. In this regard, the following considerations are relevant.

[143] First, as discussed above, I do not think it is accurate to say that Garland's level of knowledge regarding TPC's operations was so limited that he did not understand that TPC was running the significant risks in its operations described above, and was prepared to have TPC continue to do so despite the possibility of harmful consequences.

[144] Second, as an experienced businessman, Garland was aware that the existence of a deficit could eventually pose problems for TPC's operations. Any deficit would necessarily pose an issue for cash flow management. I also think that Garland could not reasonably have failed to understand that the overdrafts in the Tax Account were red flags of an underlying problem that required an investigation. They were not simply a customary or necessary feature of the operations of any payroll processor. Garland was sufficiently concerned that he asked his daughter to attempt to quantify the extent of the deficit. He does not suggest that her examination satisfied him that the deficit did not exist. However, after his daughter proved unable to quantify the deficit, he put the issue aside. From this point forward, he appears to have turned a blind eye to the existence and significance of the deficit. In short, he was prepared to run the risk that this might prove significant rather than spend more time and money getting an appreciation of the problem.

[145] Third, it is significant that there was never any basis in the facts before Garland to support or justify the explanation given to the T-D regarding the overdrafts. Whether Garland knew or suspected that the reason was the existence of the deficit is less clear, but in my opinion that is not relevant. Garland does not suggest that he ever asked his staff for evidence to support this explanation, let alone that he was ever shown any evidence to support it. Garland chose to run the risk that the explanation was incorrect, given the absence of any evidence to support it.

[146] Lastly, it is important to place Garland's actions in acquiescing in the explanation given to the T-D for the overdrafts in the context of TPC's financial position. If TPC had been unable to provide the T-D with an explanation for the overdrafts that was limited to timing differences that would be cleared within a short period of time, it is likely that the T-D would have imposed financial requirements on TPC as a condition of continued access to its electronic banking facilities. However, it is clear from the record that Garland had no intention of putting more money into TPC than he absolutely needed to. For example, as mentioned, he regularly caused TPN to transfer money from the TPN tax and payroll accounts to the Tax Account to cover overdrafts, rather than injecting additional monies to remedy the underlying cash flow problem. He also caused TPC to transfer monies in the Tax Account to the Operating Account to be applied for TPC's corporate purposes. Throughout the period, he chose not to investigate whether, and to what extent, a cash flow deficit existed, apart from the inadequate and inconclusive investigation conducted by his daughter. I have no doubt that this consideration affected Garland's view of the extent to which he should conduct a more detailed examination of the basis for the explanation given to the T-D for the overdrafts. In other words, whatever the inadequacies of the informational basis for the explanation, it satisfied the T-D and thereby avoided additional financial obligations on Garland's part.

[147] Similarly, to the extent that Garland says he relied on the T-D's willingness to accept overdrafts in the Tax Account, in my view the "wish was father to the thought" and was patently unreasonable. The submission would have some force if Garland had discussed the situation with any of the T-D client service representatives on the occasion of their telephone calls regarding overdrafts. However, there is no suggestion he ever chose to clarify the operating arrangements with the T-D. Moreover, he was aware that there was no operating line in place to fund the overdrafts he says the T-D was willing to accept, much less any security. I think it is far more likely that Garland chose not to devote any time to clarifying the working arrangements as it could only have raised issues with the T-D that he preferred not to have to deal with. Instead, he chose to continue in the historical manner in the hope that his efforts to put TPC in a position to sell additional franchises would address its financial issues.

[148] Taking into consideration the foregoing, I am not persuaded that Garland's assertion of a lack of knowledge is a sufficient answer to the T-D's contention that his actions, as the controlling mind and will of TPC, constituted recklessness in respect of the continuing representations made to the T-D concerning the overdrafts in the Tax Account.

[149] Taking Garland's position at its highest – that he did not understand the operations of TPC and its attendant risks – the fact remains that, as an experienced businessman, he

could not reasonably have failed to understand that, under his direction, TPC was run in a manner that entailed significant and increasing risks that could result in the failure of the Business. Garland accepted these potential risks to the financial position of TPC. Instead, Garland chose to put his faith in his ability to put TPC's operations on a more profitable and automated basis and to sell additional franchises, the capital fees from which were to go to the Tax Account to remedy any cash flow deficiencies. Unfortunately, he was unable to implement this strategy before the events giving rise to this litigation. The fact that he concentrated his efforts in this area does not, however, exclude a knowledge of TPC's underlying financial problems and risks.

[150] I think the explanation for the overdrafts given to the T-D must be understood and assessed in the larger context of Garland's management of TPC's operation as described above. Garland managed TPC in a reckless manner, particularly given the fact that it was responsible for other people's money. The explanation given to the T-D for the overdrafts was generated in this context and reflects Garland's willingness to run the risk of financial default in TPC's operations. In doing so, he had to have been aware of the consequences of any such default but preferred to concentrate on other matters rather than on understanding and addressing TPC's cash flow problems. On this basis, I conclude that Garland's representations to the T-D respecting the explanation for the overdrafts in the Tax Account were made recklessly, as that term is understood for the purposes of the law of deceit.

Conclusions

[151] Based on the foregoing, I make the following determinations:

1. The plaintiffs' claim of \$1,327,616 against the T-D for knowing receipt of trust funds, being funds pushed from the Payroll Account to the Tax Account on January 20, 2011 and January 21, 2011, is dismissed;
2. The plaintiffs are entitled to judgment in their favour in the amount of \$1,000,000 against the T-D for knowing assistance in a breach of trust, being the payment of \$1,000,000 on February 2, 2011 from the Payroll Account to the TPN payroll account; and
3. The T-D is entitled to judgment against Garland, on the grounds of deceit, in the amount of \$1,040,284.43, being the amount of the overdraft in the Tax Account set up as an unsecured loan on January 28, 2011.

The T-D's Claim for Contribution or Indemnity

[152] Given the determination in item #2 above, the T-D seeks contribution or indemnity from Garland who, as mentioned, has consented to several liability in respect of the same amount.

[153] Garland argues that the loss should fall where it may pursuant to the principle of *ex turpi causa*. However, he did not provide the Court with any case law addressing the

operation of this principle in the context of a breach of trust. Moreover, the issue was not the subject of submissions of the T-D since its position was that it had no such liability.

[154] Accordingly, the issue of the extent, if any, of the T-D's entitlement to claim for contribution or indemnity has not been argued in any detail before the Court. I think both parties should be given an opportunity to address this issue more fully in light of the specific findings of the Court upon which it has based its determination that the T-D is liable for knowing assistance in the breach of trust constituted by the payment of \$1 million on February 2, 2011 from the Payroll Account to the TPN payroll account.

[155] Accordingly, the T-D shall have thirty days from the date of release of these Reasons to submit written submissions addressing its claim for contribution or indemnity in the present circumstances. Garland shall have a further fifteen days to provide written responding submissions.

Costs

[156] In view of the remaining issue of the T-D claim for contribution or indemnity to be addressed as set out above, the Court proposes to address written submissions on costs after the Court has rendered a decision in respect of such issue. The parties are at liberty to schedule a 9:30 a.m. conference if they wish to address this matter on a different basis.

Wilton-Siegel J.

Released: November 7, 2014

CITATION: Carriere Industrial Supply Ltd. v. The Toronto Dominion Bank, 2014 ONSC 6489
COURT FILE NO.: CV-12-9838-00CL
DATE: 20141107

ONTARIO

SUPERIOR COURT OF JUSTICE

B E T W E E N:

CARRIERE INDUSTRIAL SUPPLY LIMITED
and DIBRINA SURE BENEFITS
CONSULTING INC.

Plaintiffs

- and -

THE TORONTO-DOMINION BANK, 2026227
ONTARIO LIMITED, 2140074 ONTARIO
INC., JAMES GARLAND and JOHN DAVIS

Defendants

AND BETWEEN:

THE TORONTO-DOMINION BANK

Plaintiff by Crossclaim

- and -

2026227 ONTARIO LIMITED, 2140074
ONTARIO INC. JAMES GARLAND and
JOHN DAVIS

Defendants to the Crossclaim

REASONS FOR JUDGMENT

H. Wilton-Siegel J.

2014 ONSC 6489 (CanLII)

Released: November 7, 2014