

APPENDIX
XII

COURT OF APPEAL FOR ONTARIO

CITATION: Carriere Industrial Supply Limited v. Toronto-Dominion Bank,
2015 ONCA 852
DATE: 20151207
DOCKET: C59688

Simmons, van Rensburg and Hourigan J.J.A.

BETWEEN

Carriere Industrial Supply Limited and
Dibrina Sure Benefits Consulting Inc.

Plaintiffs (Respondents/
Appellants by way of cross-appeal)

and

The Toronto-Dominion Bank, 2026227 Ontario Inc.,
2140074 Ontario Inc., James Garland and John Davis

Defendants (Appellant/
Respondent by way of cross-appeal)

Geoff R. Hall and Richard J. Lizius, for the appellant/respondent by way of cross-appeal

J. Anthony Caldwell, for the respondents/appellants by way of cross-appeal

Heard: November 9, 2015

On appeal from the judgment of Justice Herman Wilton-Siegel of the Superior Court of Justice, dated November 7, 2014.

ENDORSEMENT

[1] Following a four-day trial, the trial judge found The Toronto-Dominion Bank (the "Bank") liable to the respondents, Carriere Industrial Supply Limited and Dibrina Sure Benefits Consulting Inc., for knowing assistance in a breach of trust in relation to a payment on February 2, 2011 of \$1,000,000 from the payroll account of 2026227 Ontario Inc. ("TPC") into the payroll account of 2140074 Ontario Inc. ("TPN").

[2] The trial judge dismissed the respondents' claim against the Bank for knowing receipt of trust funds in relation to \$1,327,616 transferred by TPC on January 20 and 21, 2011 from its payroll account to its tax account, which had the effect of reducing, but not eliminating, an existing overdraft in the tax account.

[3] The Bank appeals from the finding of liability for knowing assistance in a breach of trust.

[4] The respondents cross-appeal from the dismissal of their claim for knowing receipt of trust funds.

The Participants

[5] TPC and its franchisees carried on a payroll processing and payment business and for that purpose obtained banking services from the Bank to service their approximately 1500 clients.

[6] TPN is a wholly owned subsidiary and franchisee of TPC and from and after 2009 carried on a similar business for about 300 clients.

[7] The respondents are representative plaintiffs appointed to represent the interests of 416 claimants who were customers of TPC and its franchisees, and who suffered a loss as a result of events that occurred between January and March 2011.

The Payroll and Tax Accounts

[8] Both TPC and TPN maintained at least three accounts for business purposes at the Bank: an operating account, a payroll account and a tax account.

[9] To the Bank's knowledge, the payroll accounts and the tax accounts were trust accounts containing funds TPC and TPN obtained from their clients and which they were obliged to remit on account of payroll amounts owing to their clients' employees and future tax payments owing in relation to such amounts to the relevant authorities.

[10] When providing services to their employer clients, on the evening of the first day of the payment cycle, TPC and TPN "pulled" an automated debit from their clients' accounts and deposited the debit amount into their payroll accounts. The automated debit amount consisted of: the net payroll amount to be paid to the client's employees; the tax remittance for each client, including the employer remittance amount; and the processing fee charged to the client.

[11] On the morning of the second day of the payment cycle, the debit amount was segregated into three separate amounts and "pushed" in three separate transfers as follows: the net payroll amount to the Bank for deposit into individual

employee accounts (received on the morning of the fourth day of the payment cycle); the tax remittance amount owing on account of future tax payments to the tax account (received on the fourth day of the payment cycle); and the processing fee to the operating account (received on the fourth day of the payment cycle).

The Operation of the Payroll and Tax Accounts Prior to 2011

[12] James Garland acquired TPC and TPN in 2003. At or around the time of the acquisition, Garland was told that a possible deficit existed in TPC's tax account of between \$250,000 and \$300,000. Further, on his examination for discovery, Garland acknowledged that TPC used funds in its tax account not immediately required to fund tax remittances to pay TPC operating expenses. On average, the funds so used amounted to about \$65,000 per year, totaling about \$520,000 for the period from 2003 to 2011.

[13] Apart from a small overdraft line of credit for the first two years after 2003, TPC did not maintain any line of credit or overdraft facilities with the Bank for the purpose of its operations. Nonetheless, on approximately 100 occasions between 2003 and 2011, an overdraft remained in TPC's tax account at the end of the business day. The trial judge was satisfied that a Bank representative contacted TPC concerning these overdrafts on most if not all occasions and that the representative was told that the overdraft was due to a timing difference between

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

The Events Giving Rise to the Litigation

[14] Because of an overdraft in TPC's tax account that arose in early January 2011 and increased thereafter, on January 25, 2011, Garland agreed to have TPC engage BDO Canada Inc. to conduct an investigation of TPC's affairs.

[15] BDO concluded that on or around January 6, 2011, TPC made a significant overpayment from its tax account to the Canada Revenue Agency (the "CRA"). This caused an overdraft that increased over time. Ultimately, BDO's investigation revealed an overall underlying shortfall in TPC's tax account of approximately \$2.4 million.

[16] On January 20 and 21, 2011, before the BDO investigation commenced, TPC pushed \$1,327,616 from its payroll account to its tax account, thereby reducing, but not eliminating, the overdraft that then existed. In so doing, TPC used funds held in trust to fund future tax remittances to reduce an underlying shortfall in its tax account.

[17] On January 28, 2011, before the results of the BDO investigation were in, the Bank set up an unsolicited demand loan for TPC in the amount of \$1,040,284.43, thereby reducing the overdraft in the tax account to \$0. At that time, the Bank advised TPC that it could continue to operate but that no further overdrafts in its tax account would be permitted.

[18] On February 2, 2011, TPC made an electronic transfer of funds from its payroll account to TPN's payroll account, in purported repayment of a loan between those accounts made in October 2010. On February 10, 2011, Garland advised the Bank that TPC could no longer carry on its business. The Bank therefore froze TPC's accounts.

The Respondents' Claims

[19] Among other things, the respondents claimed that the Bank should repay the sum of \$1,327,626 transferred by TPC from its payroll account to its tax account on January 20 and 21, 2011 based on the doctrine of knowing receipt of trust funds, as that transfer operated to reduce the overdraft owing to the Bank on that date.

[20] The respondents also claimed that the Bank should pay the sum of \$1,000,000 transferred from the TPC payroll account to the TPN payroll account on February 2, 2011, based on the doctrine of knowing assistance in a breach of trust.

The Trial Judge's Findings

[21] The trial judge rejected the respondents' claim based on knowing receipt of trust funds. Although the trial judge was satisfied that the Bank knew TPC's payroll and tax accounts were trust accounts, he was not satisfied the Bank was aware the tax account was operating in a deficit position when Garland acquired TPC. Further, he was not satisfied that the continuing and increasing overdrafts

in the TPC tax accounts and the advice the Bank received that the overdrafts were being covered in part by monies from related parties triggered a duty on the Bank to inquire into the source of the deficits.

[22] This was because TPC did not have any credit facilities with, or reporting obligations to, the Bank. Further, TPC had always provided an explanation to the Bank that the overdrafts arose due to timing differences in payments and payouts and had always previously covered the overdrafts within the 48-hour time period the Bank had for recourse against the payments that caused the overdrafts, albeit on at least one occasion through a transfer made from TPN. In the trial judge's view, in these circumstances the Bank had no basis on which to reject TPC's explanation, absent knowledge of the deficit in the tax account.

[23] Further, the trial judge was not satisfied that the respondents had established that the \$1,327,626 transferred by TPC was "a receipt" as required under the doctrine of knowing receipt. The fact that this sum operated to reduce TPC's overdraft to the Bank in this case was a function of the timing of the transfer of funds and the due date of the remittances to the CRA – it did not happen because of any independent action on the part of the Bank.

[24] However, the trial judge allowed the respondents' claim for knowing assistance in a breach of trust. He concluded that the \$1,000,000 transfer from TPC's payroll account to TPN's payroll account was patently a breach of trust and that the Bank participated in the breach by continuing to grant TPC access to

electronic banking facilities. He found the knowledge requirement for knowing assistance was met because the Bank had recognized the existence of a deficit in the tax account – a trust account, which should not have a deficit – when it converted the overdraft to a loan. Further, Garland had raised the possibility of a fraud in a meeting with the Bank on January 25, 2011. In these circumstances, the trial judge concluded the Bank acted recklessly in allowing TPC to continue to access electronic banking facilities on an unmonitored basis in relation to the payroll account.

The Appeal

[25] The Bank raises three issues on its appeal from the finding of liability for knowing assistance. First, it claims that the trial judge misapplied the knowledge requirement for knowing assistance in a breach of trust. Second, it argues that the trial judge erred in finding the Bank could have put in place a system of pre-approval for the electronic banking facilities in relation to the payroll account in the absence of any evidence concerning that issue. Third, it claims that the trial judge erred in holding that failing to put in place a monitoring system, or failing to withdraw electronic banking services, can constitute “assistance” for the purpose of liability under the doctrine of knowing assistance in a breach of trust. In the Bank’s view, this amounts to imposing liability for nonfeasance, which it asserts is impermissible.

[26] We do not accept these arguments.

[27] Concerning the first issue, at paras. 84 and 85 of his reasons, the trial judge accurately set out the knowledge requirement for knowing assistance in a breach of trust.

[28] Further, contrary to the Bank's assertion, we are not persuaded that the trial judge found the requisite knowledge based on a failure to monitor TPC's activities and that he therefore blurred the distinction between actual and constructive knowledge.

[29] Rather, in our view, the trial judge found the requisite knowledge based on the fact that the Bank had become aware of the existence of a deficit in the tax account – a trust account, which should not operate at a deficit – in late January, when it converted TPC's continuing overdraft into a demand loan, and the further fact that Garland had raised the possibility of a fraud in the January 25, 2011 meeting. In these circumstances, the Bank advised TPC it would permit the tax account to continue to operate only on the basis of funds in hand.

[30] As stated by the trial judge at para. 94, the Bank "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." In continuing to afford unmonitored access to electronic banking facilities in the face of this knowledge, the trial judge found the Bank acted recklessly.

[31] As we read the trial judge's reasons, the knowledge component of his conclusion was premised on the information the Bank had, not on its failure to

acquire additional information through monitoring. As the Supreme Court of Canada stated in *R. v. Sansregret*, [1985] 1 S.C.R. 570, 17 D.L.R. (4th) 577, recklessness consists of knowledge of a danger or risk and persistence in a course of conduct that creates a risk that the prohibited result will occur. In our view, the trial judge did not misapply this definition.

[32] Concerning the second issue, there was some limited evidence from a bank employee on cross-examination indicating it could have been possible to put in place a system requiring pre-approval of payments out of the TPC payroll account. However, even if this evidence was insufficient to support the trial judge's finding concerning monitoring, it is not disputed that the Bank could have frozen TPC's payroll account. Although freezing the payroll account may have prevented TPC from doing business pending delivery of the BDO report, in the light of the trial judge's finding concerning the Bank's knowledge, the Bank was not justified in giving TPC unfettered access to electronic banking in the meantime.

[33] Concerning the third issue, at its core, the trial judge's finding was that the Bank participated in the breach of trust by continuing to grant TPC access to its electronic banking facilities – the means by which the fraud was perpetrated – when it “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.” We see nothing improper about the trial judge's conclusion that

by continuing to afford access to its electronic banking facilities in the face of this knowledge, the Bank participated in a breach of trust. Such conduct goes beyond a mere failure to act. By permitting TPC continued access to electronic banking facilities, the Bank afforded TPC the means to perpetrate a fraudulent breach of trust.

The Cross-Appeal

[34] The respondents cross-appeal the trial judge's finding that the Bank is not liable for knowing receipt of trust funds in relation to the funds transferred by TPC from its payroll account to its tax account on January 20-21, 2011. They raise two issues by way of cross-appeal. First, they argue that the trial judge erred in holding that the reduction of the overdraft was not a "receipt" within the meaning of the doctrine of knowing receipt. Second, they argue that the trial judge erred in law when he found that the Bank had no obligation to inquire into the reasons for the overdrafts.

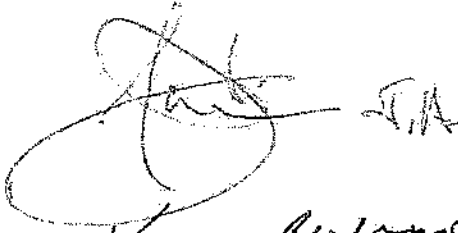

[35] We begin with the second issue. The trial judge's conclusion that the Bank had no obligation to inquire into the reason for the overdraft was a conclusion premised on findings of fact. As we have summarized above, the trial judge was satisfied that as of the date of the impugned transfers, the Bank was not aware that TPC's tax account was operating at a deficit and therefore had no basis to inquire into TPC's explanation concerning why the overdrafts were occurring. In our view, the trial judge was assessing the Bank's conduct on an objective basis.

Moreover, we are not satisfied that the respondents have demonstrated any palpable and overriding error in the trial judge's findings. The fact that a forensic examination of TPC's tax account might reveal some prior failure to cover an overdraft within the requisite period does not mean the Bank was aware of it. Accordingly, we see no basis on which to interfere with the trial judge's conclusion.

[36] In the circumstances, it is unnecessary that we consider the first issue raised. However, nothing in these reasons should be taken as endorsing the trial judge's conclusion on that issue.

Disposition

[37] Based on the foregoing reasons, the appeal and cross-appeal are dismissed. In accordance with the parties' submissions, we order no costs of the appeal and cross-appeal.


L. v. Ruyoga.
 J.A.