CITATION: Boughner v. Greyhawk Equity Partners Limited Partnership (Millenium), 2012 ONSC 3185
COURT FILE NO.: CV-119089-00CL
DATE: 20120716

SUPERIOR COURT OF JUSTICE – ONTARIO
(COMMERCIAL LIST)

RE: **JAMES BOUGHNER, RICHARD GIBSON and JACK WALDOCK, Plaintiffs**

AND:

GREYHAWK EQUITY PARTNERS LIMITED PARTNERSHIP (MILLENIUM), GREYHAWK EQUITY PARTNERS LTD., BEDFORD AND ASSOCIATES RESEARCH GROUP INC., TERRENCE M. BEDFORD and JOANNE HARRIS-BEDFORD, Defendants

BEFORE: **MORAWETZ J.**

COUNSEL: **John Pirie and David Gadsden, for Jack Waldock and the Waldock Group**

Orestes Pasparakis and Alex Dimson for Richard Gibson

Paul Michell and Daniel Naymark, for A. Farber & Partners Inc., Receiver

ENDORSEMENT

OVERVIEW

[1] The issue to be determined is how to distribute commingled funds to the victims of a fraudulent investment scheme called the "Greyhawk Fund" ("Greyhawk" or the "Fund"). Following the discovery of the fraud and the appointment of A. Farber & Partners Inc. as receiver (the "Receiver"), a significant shortfall was discovered. The Receiver wishes to distribute the remaining funds; however, there is disagreement amongst the investors regarding the appropriate method of distribution.

[2] Jack Waldock and the Waldock Group (together, "Waldock"), argue that the remaining funds should be distributed *pro rata* based on original contributions to the fund. This method is referred to as the "*pro rata*" method or the "*pro rata ex post facto*" method.

[3] Richard Gibson ("Gibson") argues that distributions should be made *pro rata* based on actual fund performance during the period while each investor was invested in the fund. The

method proposed by Gibson is generally known as the Lowest Intermediate Balance Rule ("LIBR"). The Receiver refers to it as the "fund unit allocation" method. It has also been referred to in case-law and elsewhere as "*pro rata* on the basis of tracing," the "North American" method, and the "Rolling Charge" method. Under LIBR, an investor cannot claim an amount in excess of the lowest balance in a fund subsequent to their investment and attributable thereto.

[4] An example fact pattern is illustrative in demonstrating the difference between the methods advocated by Waldock and Gibson: A invests $100 in a fund. The value of the fund then declines to $50. B invests $100, bringing the balance in the fund to $150. The value of the fund then declines to $120.

[5] In this fact pattern, if LIBR were applied, A could not claim more than $50, because that is the lowest balance in the fund prior to B's investment. In other words, the initial decline in the value of the fund from $100 to $50 is borne entirely by A. When B contributes $100, her investment constitutes 2/3 of the $150 in the fund. As a result, when the fund declines to $120, 2/3 of the decline is borne by B, while 1/3 is borne by A. Therefore, of the $120 remaining in the fund, A can claim $40 while B can claim $80.

[6] If, on the other hand, the funds were distributed *pro rata* based on original contributions, as Waldock maintains should occur in the present case, both A and B would receive $60, since both invested an equal amount: $100.

[7] Which method is applied in the present circumstances will have significant financial consequences for the parties. The Receiver has calculated that if the funds are distributed using the *pro rata* method, Waldock will receive $694,856, and Gibson will receive $216,196. If the funds are distributed using LIBR, Waldock will receive $139,130, and Gibson will receive $958,662. The dollar amounts referred to throughout this endorsement are based on calculations performed by the Receiver.

FACTS

[8] The facts are generally not in dispute.

[9] Investors were duped into believing that the fraudulent Greyhawk Fund was a large, highly profitable investment vehicle. Investors were provided with fictitious account statements, financial reports, and audit reports. They were allocated units on the basis of their investments, and they received monthly reports suggesting that the value of their units was increasing. However, the unit values were fabricated and actual fund performance was consistently negative. Thus, the reported unit values bore no relation to the actual value of each investor's investment.

[10] During the life of the fraud, the deposits of 24 investors were commingled in a number of electronic trading accounts, which were then used to purchase and sell a variety of securities. The Greyhawk Fund consistently lost money and its value declined significantly from 2000 to 2008.

[11] Waldock was the first investor in the Greyhawk Fund, with an investment of $1 million in July, 2000. By November 1, 2002, Waldock had invested $4,214,014.64 in the Fund. James

Boughner was the next investor in the Fund. Between November, 2000 and December 31, 2010, Boughner invested $3,056,818 in the Fund.

[12] Nobody else invested in the Fund until April, 2008. By that time, $4,717,068 had been invested by Waldock and Boughner, but the Fund had been depleted to $542,919.

[13] Waldock recommended the Greyhawk Fund to Gibson in early 2008, and on April 30, 2008, Gibson invested $1 million. By the time the Fund collapsed in January, 2011, Gibson had invested $2.2 million.

[14] After Gibson's initial investment, a number of other investors invested in the Fund, including family members of Gibson and Waldock. This brought the total number of investors to the aforementioned 24.

[15] While total Fund losses were just over $4.2 million when Gibson made his initial investment, they were approximately $5.4 million by the time the Fund collapsed.

[16] In January, 2011, Gibson's son, Glen, discovered an error in the financial statements that were purportedly prepared by PricewaterhouseCoopers ("PwC"). Glen Gibson contacted PwC and learned that PwC did not conduct any audit of the Greyhawk Fund. PwC confirmed that the statements were not prepared or signed by PwC, but were in fact forged. PwC advised the Ontario Securities Commission of the matter.

[17] On February 11, 2011, the court ordered the appointment of the Receiver over Greyhawk and related entities.

[18] The Receiver determined the present market value of the Fund to be US $3.871 million and estimated a shortfall of approximately US $3.526 million. The shortfall represents the loss of principle amounts invested by the remaining investors (*i.e.* those investors who did not redeem their investments prior to the discovery of the fraud).

[19] The Receiver suggested three methods of allocating the remaining funds to the remaining investors:

a) *Pro rata* based on original contributions, as described above;

b) LIBR, as described above;

c) "Last in, first out" (or "LIFO", and also known as the "rule in Clayton's Case"), which is not supported by any party in this motion.

[20] The Receiver's evidence is that it has been able to properly calculate the distributions to each party using both methods (a) and (b) above. With respect to calculating distributions based on LIBR, the Receiver was asked: "[i]s the [LIBR calculation] complete, or would further calculations and refinements be required before that methodology could be applied to accurately distribute the Greyhawk proceeds at issue?" The Receiver responded: "No further calculations remain to be done, unless any redemptions are repaid to the fund or otherwise made available for

distribution, in which case the present calculations would need to be refined to account for the additional funds received by the Receiver".

POSITION OF WALDOCK

[21] Counsel to Waldock takes the position that the case-law and equitable principles direct in favour of distributing the remaining funds *pro rata* based on original contributions.

[22] Counsel submits that courts have determined that, as a general rule, *pro rata* distribution is appropriate where an account is in a shortfall position, funds have been commingled by a wrongdoer, and the remaining funds are to be distributed amongst innocent beneficiaries. In support of this proposition, counsel cites *Law Society of Upper Canada v. Toronto-Dominion Bank* (1998), 42 O.R. (3d) 257 (C.A.) ["*Law Society*"] at paras. 12, 34-35, leave to appeal to S.C.C. refused [1999], S.C.C.A. No. 77; *Ontario Securities Commission v. Greymac Credit Corp.* (1986), 55 O.R. (2d) 673 (C.A.) ["*Greymac*"] at para. 18, aff'd 59 O.R. (2d) 480 (S.C.C.); *Ontario Securities Commission v. Consortium Construction Inc.*, [1993] O.J. No. 1408 (Gen. Div.) ["*Consortium*"] at paras. 68-69; and *Winsor v. Bajal* (1990), 1 O.R. (3d) 714 (Gen. Div.) at paras. 20-22.

[23] Counsel to Waldock cites *Greymac* and *Law Society* for the proposition that in determining the appropriate method to distribute remaining funds to innocent beneficiaries, where a portion of the funds has been misappropriated by a wrongdoer, the court should apply the method that is most just, convenient and equitable in the circumstances. Counsel submits that a *pro rata* distribution is just and equitable because, unlike LIBR, it does not rely on "happenstance" and the timing of investments to prioritize certain investors over others.

[24] *Law Society*, *Greymac* and *Consortium* are cited for the proposition that the following factors support a *pro rata* distribution: (a) the funds of multiple beneficiaries have been commingled, (b) the dispute as to the appropriate method of distribution is between innocent investors as opposed to between an alleged trust beneficiary and creditors, and (c) it is the most convenient method.

[25] Counsel to Waldock maintains that courts have only used methods other than *pro rata* in limited circumstances, such as when it is necessary to determine whether certain funds should form part of a trust and where the dispute over the remaining funds was between an alleged trust beneficiary and general creditors (*i.e.* where priority is at issue), rather than between similarly placed beneficiaries. In support of this argument, counsel cites *Graphicshoppe Ltd. (Re)*, [2005] O.J. No. 5184 (C.A.) ["*Graphicshoppe*"] at paras. 125-127; *Corp. Jetsgo, Re*, 2010 QCCA 1286 at para. 67; and *389179 Ontario Ltd. (No. 3), Re*, [1980] 113 D.L.R. (3d) 207 (Bktcy) at para. 22.

[26] Counsel takes the position that the leading case applicable to the present circumstances is *Law Society*, in which competing innocent beneficiaries faced a shortfall of funds in a trust account in which monies were commingled and misappropriated by a solicitor. Counsel notes that at para. 7 in *Law Society* the court stated that once a contribution is deposited into a commingled investment account it is no longer possible to identify a claimant's deposit as that specific claimant's funds. Rather, counsel contends that *Law Society* established that a commingled fund should be considered a whole fund, and that the timing of investments is

irrelevant in an investment fraud scheme. As such, all beneficiaries have an equal claim against the funds in a commingled account.

[27] Counsel further submits that *Law Society* and *Graphicshoppe* direct that LIBR is only appropriate where it is a wrongdoer and an innocent beneficiary competing over remaining funds, rather than multiple innocent beneficiaries, in which case *pro rata* distribution is appropriate. Counsel submits that under factually similar circumstances, the court in *Law Society* applied a *pro rata* distribution, citing the following passage from para. 32 of *Law Society*: "[n]o authority has ever applied [LIBR] in circumstances involving the rival claims of trust beneficiaries." Counsel also submits that in *Greymac* the Court of Appeal held that *pro rata* distribution is logical and just in circumstances involving competing innocent beneficiaries.

[28] Counsel to Waldock submits that the above authorities are relevant in these circumstances as all of the Greyhawk Fund investors were equally deceived. Before the fraud was uncovered, none of the victims knew that the account statements were fictitious. Thus, this is a case involving similarly situated wronged parties, which, counsel submits, justifies a *pro rata* distribution.

[29] Counsel to Waldock also submits that applying LIBR would arbitrarily punish innocent investors based on the timing of their contributions to the Greyhawk Fund. Counsel maintains that it would unfairly punish early investors to the benefit of later investors. Counsel again cites *Law Society*, noting that the court determined that it would not be appropriate to limit the recovery of innocent beneficiaries based on the timing of contributions and distributions, and that to apply LIBR would create an "illogical preference for later investors". This is particularly the case, they argue, when none of the investors knew of the fraud until 2011.

[30] Counsel to Waldock also takes the position that a *pro rata* distribution would be more convenient, and that LIBR is not workable in the present circumstances. Counsel maintains that courts have historically preferred the *pro rata* method because it is more convenient and workable, especially when dealing with competing claims to a commingled fund by innocent beneficiaries.

[31] Counsel submits that it would be unworkable to apply LIBR because:

a) it is not possible to earmark funds or match trades made to specific investors,

b) the Receiver has indicated that it would be costly and time-consuming to use daily trading statements to recreate the actual inflows and outflows in the trading accounts in the Greyhawk Fund (the Receiver has, instead, used monthly statements),

c) there were no individual trading accounts to trace investments into, and

d) the securities that were converted to cash by the Receiver cannot be earmarked to original investments by the parties.

[32] Counsel takes the position that while the Receiver has done the best it can to calculate the amounts to be distributed under the LIBR method, "the various assumptions under this method

would not depict an accurate tracing of assets". Specifically, counsel takes issue with the following assumptions made by the Receiver:

a) investments and redemptions are calculated based on the month-end market value of the Greyhawk Fund regardless of when during the month the investment and/or redemption took place;

b) the notional unit price at the inception of the Greyhawk Fund was $1,000;

c) any dividend and interest income has been included in the amounts of the monthly market value statements of the investment trading accounts; and,

d) investor redemptions have been calculated based on the market value of the Greyhawk Fund at the time of the redemption, notwithstanding that the redemption amount exceeded the number of units the investor owned.

[33] Counsel notes that because some investors redeemed their investments before the discovery of the fraud, for those investors the Receiver was required to allocate a number of units that would have exceeded the amount of units they actually held at the time based on the true market value of the Fund. As a result, the remaining investors are still "paying" for the gains of the investors who redeemed earlier, obtaining false profits.

[34] Finally, Counsel to Waldock takes the position that U.S. courts have applied the *pro rata* method in similar circumstances. Counsel cites *Cunningham v. Brown*, [1924] 265 U.S. 1, 13 (U.S. Sup. Crt.) ["*Cunningham*"], in which the United States Supreme Court upheld the principle of equality for similarly situated victims in the famous investment fraud scheme of Charles Ponzi. Counsel also cites *SEC v. Credit Bancorp, Ltd*, 290 F. 3d 80, 89 (2d Cir. 2002) and *United States v. Durham*, 86 F. 3d 70, 72 (5th Cir. 2001) for the proposition that a *pro rata* distribution is appropriate in the case of victims of ponzi schemes in which earlier investors' returns are generated by the influx of fresh capital from new investors.

POSITION OF GIBSON

[35] Counsel to Gibson agrees with counsel to Waldock's assertion that the test as to how best to distribute the remaining funds is to determine which method is "just, convenient and equitable".

[36] In response to the assertion by counsel to Waldock that it would be unworkable to apply LIBR in these circumstances, counsel to Gibson submits that this is not the evidence of the Receiver. Rather, counsel to Gibson notes that the Receiver confirmed that its LIBR calculations are complete. As indicated above, the Receiver was asked: "[i]s the [LIBR calculation] complete, or would further calculations and refinements be required before that methodology could be applied to accurately distribute the Greyhawk proceeds at issue?" The Receiver responded: "No further calculations remain to be done, unless any redemptions are repaid to the fund or otherwise made available for distribution, in which case the present calculations would need to be refined to account for the additional funds received by the Receiver".

[37] Counsel to Gibson takes the position that counsel to Waldock has misconstrued the issue in this case, emphasizing that both parties are advocating a method of distribution that could be referred to as a *pro rata* distribution. The LIBR method still incorporates *pro rata* calculations, but the manner in which Gibson proposes that the proportionate shares be calculated differs from Waldock. Counsel to Gibson explains the difference as follows:

> Waldock advances what has been described in the jurisprudence as the "*pro rata ex post facto* approach" whereby commingled monies are distributed *pro rata* based on the original contributions to the fund; whereas Gibson supports an approach whereby commingled monies are distributed *pro rata* based on the value of the contributions at the time the funds are commingled.

In *Greymac*, Morden J.A. referred to the latter approach as "*pro rata* sharing on the basis of tracing."

[38] Counsel to Gibson cites an example given in the Law Reform Commission of British Columbia, *Report on Competing Rights to Mingled Property: Tracing and the Rule in Clayton's Case*, (Vancouver, 1983) ["Law Reform Commission Report"]: A, a trustee, deposits $1,000 of B's money in his account, mixing it with $1,000 of his own money. A removes $1,500. A then deposits $1,000 of C's money. Following C's deposit, there is $1,500 in the account.

[39] Following the position of Waldock, the funds would be distributed *pro rata* based on original contributions. As both B and C originally contributed $1,000, they would each receive an equal $750. Following the position of Gibson, on the other hand, the funds would be distributed *pro rata* in accordance with the value of the contributions at the time of the commingling. B would receive $500, and C $1,000.

[40] Counsel to Gibson cites page 54 of the Law Reform Commission Report for its reason for preferring Gibson's approach:

> B and C should not share in the $1,500 equally, notwithstanding that B's original interest in the fund was $1,000 and that C's current interest is $1,000. B's interest in the fund has been reduced by $500. B's lien should be reduced from security $1,000 to now security $500, the minimum balance of the fund following the deposit of his money and preceding the deposit of C's money. C would be entitled to a lien of $1,000. No transactions have occurred yet to reduce his interest in the fund.

[41] Counsel to Gibson also cites the opinion of Judge Learned Hand in *Re: Walter J. Schmidt & Co.* (1923), 298 F. 314 (DC NY), where Judge Hand used an example that is analogous to the present circumstances, and favoured the equivalent of the LIBR approach.

[42] Counsel also submits that by advocating for *pro rata* distribution, Waldock is attempting to "throw" his losses on to Gibson and claim a portion of Gibson's deposit. As evidence of this, counsel cites the Receiver's calculations for the two approaches both immediately prior to Gibson's investment as well as after that investment. Prior to Gibson's investment, Waldock would have had a claim to $298,708 using the *pro rata* method and $145,130 using the LIBR method. One month after Gibson's investment, those numbers would be $694,856 under the *pro*

rata method and $139,130 applying LIBR. Counsel notes that using the *pro rata* method Waldock's claim increases substantially after Gibson's investment, indicating that Waldock is taking monies that can be attributed to that investment. Counsel submits that there is no reason in equity why Waldock should benefit from Gibson's investment, and notes Lord Justice Dillon's observation of same in *Barlow Clowes International Ltd. v. Vaughan*, [1992] 4 All E.R. 22 (C.A.) [*Barlow*]: "[*pro rata*] distribution among all seems unfair to late investors."

[43] While LIBR was not applied in *Barlow*, this was because the court faced 11,000 claimants, and thus determined that the "most just result" was impractical in that case.

[44] Counsel to Gibson also cites *Waters' Law of Trusts in Canada*, 3d ed (Toronto: Thomson Carswell, 2005) ["*Waters' Law of Trusts*"], at page 1283, for the proposition that the *pro rata* method is unfair to later investors: "Although there is a certain fairness in proportionate sharing, this approach shifts earlier losses onto later contributions, whose money could not possibly have been implicated in those losses".

[45] Counsel to Gibson notes that while the LIBR calculation is more complex in the present circumstances than in the example from the Law Reform Commission Report cited above, the Receiver's evidence, as noted above, is that it was nonetheless able to successfully perform these calculations.

[46] Counsel to Gibson also disagrees that *Greymac* supports the position of Waldock, and submits that a careful reading of that case demonstrates that Morden J.A. adopted LIBR as a general rule in circumstances such as the present case. Counsel cites page 688 of *Greymac*:

> At the time of the mingling of the trust funds the companies [i.e., one group of claimants] had $4,683,000 in the account. Regardless of how much they had earlier in the account, they cannot say that they had a proprietary interest in any more than the amount in the account to their credit on and after December 15, 1982 [the date the funds became commingled]: see James Roscoe (Bolton), Ltd. v. Winder, [1915] 1 Ch. 62, and Re Norman Estate, [1951] O.R. 752, [1952] 1 D.L.R. 174.

[47] Further, counsel to Gibson notes that, at page 688 of *Greymac*, Morden J.A. expressly rejected Waldock's approach:

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

[48] Finally, at page 689 of *Greymac*, Morden J.A. cited the *Restatement of the Law, Restitution* section 213 (1937), stating:

> I am not persuaded that considerations of possible inconvenience or unworkability should stand in the way of the acceptance, as a general rule, of [LIBR]. That it is sufficiently workable to be the general rule is indicated by the fact that it appears to be the majority rule in the United States.

[49] Thus, counsel to Gibson argues that Morden J.A.'s position in *Greymac*, at page 690, was that unless LIBR is not "practically... possible", it is the general rule. Counsel again emphasizes the Receiver's evidence, mentioned above, that it has been able to successfully calculate distributions using the LIBR method.

[50] Counsel to Gibson submits that *Greymac* is binding, as it was affirmed by the Supreme Court, which adopted "the reasons therefore delivered by Morden J.A. on behalf of the Court".

[51] Counsel disagrees with Waldock's position that *Law Society* directs in favour of employing *pro rata* distributions in the present circumstances, rather, *Law Society* is simply an example of a situation where the court determined that LIBR was unworkable. At page 271, the court in *Law Society* stated:

> There are over 100 claimants. There were misappropriations in the area of $900,000 in bits and pieces. It is not even clear that each deposit and debit can be looked at individually, on the state of the record... It is not at all clear on the evidence that this exercise can be done.

[52] Counsel to Gibson acknowledges that in *Law Society*, the court expressed the view, at page 267, that LIBR "is too complex and impractical to be accepted as a general rule for dealing with cases such as this... [even though it] may be 'manifestly fairer' in the pure sense of a tracing analysis." However, counsel notes that *Waters' Law of Trusts*, at page 1282, states that the decision in *Law Society* is contrary to "established principles," and that it has come under criticism from other academics as well: see Lionel Smith, "Tracing in Bank Accounts: The Lowest Intermediate Balance Rule on Trial" (2000), 33 Can. Bus. L.J. 75 ["Smith"].

[53] Counsel to Gibson also notes that the decision in *Law Society* turned substantially on the fact that the case involved a solicitor's trust account, which the court described as a trust for economic and organizational benefit to the public: see *Law Society*, *supra*, page 272. As noted in *Waters' Law of Trusts*, at page 1283, this means that *Law Society* "would not govern in instances which do not involve, like a solicitor's trust account, a lawfully created common trust fund".

[54] Further, counsel to Gibson maintains that the law in Ontario prescribes LIBR as the general rule in these circumstances. This, according to counsel, was subsequently supported by the majority in *Graphicshoppe*, in which, at para. 129, Moldaver J.A. (as he then was) accepted LIBR, and cited Smith, stating that he does "not see how applying [LIBR] can be erroneous, when in this case it is solidly supported by the facts."

[55] Counsel to Gibson also argues that LIBR is supported by *Underhill & Hayton: Law Relating to Trusts and Trustees*, 17d (LexisNexis Butterworths, 2006), a leading text on English trust law, as well as by the case *Shalson v. Russon* [2003] EWHC 1637 (Ch). In response to Waldock's assertion that *Cunningham*, the original ponzi scheme case from 1924, supports the *pro rata* method, counsel to Gibson notes that in that case the fraud was far too complicated to apply LIBR.

[56] Counsel to Gibson takes the position that equity directs in favour of applying LIBR in the present circumstances. Just as earlier investors would not have expected to share their gains with later investors, they should not be allowed to so share their losses.

[57] Gibson places heavy reliance on *Greymac*, in which the Court of Appeal for Ontario was faced with the question of how comingled funds should be distributed among two innocent parties where there were insufficient funds to pay both in full.

[58] In *Greymac*, Morden J.A. determined that in dividing comingled funds, a *pro rata* approach was to be preferred over the rule in Clayton's Case (or what the Receiver has described as "last in, first out" or "LIFO"). Morden J.A. concluded, at page 687, that "[t]he application of the rule in Clayton's Case to the problem under consideration is arbitrary and unfair".

[59] Counsel to Gibson submits that a careful reading of *Greymac* discloses that the court adopts as a rule *pro rata* sharing based on the value of the contributions at the time of comingling. At page 688, the court in *Greymac* stated:

> At the time of the mingling of the trust funds, the companies had $4,683,000 in the account. Regardless of how much they had earlier in the account, they cannot say that they had a proprietary interest in any more than the amount in the account to their credit on or after December 15, 1982 (the time funds were comingled): See *James Roscoe (Bolton), Ltd. v. Winder*, (1915) 1 C.H. 62 and *Re Norman Estate*, (1951) O.R. 752, (1952) 1 D.L.R. 174.

[60] At page 688, counsel submits that the court removed any doubt that it is expressly rejecting the *pro rata* method favoured by Waldock:

> While it might, possibly, be appropriate in some circumstances to recognize claims on the basis of a claimant's original contribution (but see Scott, The Law of Trust, Vol. 5, 3rd edition, (1967) at pp. 3647-52), I do not think that it is appropriate where the contributions to the mixed fund can be simply traced, as in the present case.

[61] Counsel to Gibson submits that these are the circumstances of this case. Where the various deposits into the fund are documented along with the value of the fund from time to time, the simplistic *pro rata* sharing based on original contributions ought to be rejected.

[62] Counsel to Gibson further submits that, in support of his decision to accept *pro rata* based on tracing (or LIBR) over *pro rata ex post facto*, Morden J.A. cited The Law Reform Commission and the *Restatement of the Law, Restitution*, at section 213 which affirms a *pro rata* distribution based on the value of the funds at the time they are comingled.

[63] Counsel points out that Morden J.A. also addressed the issue of convenience and accepted that a *pro rata* distribution based on original contributions is more convenient, but observed that convenience and justice are not synonymous. Counsel points out that, at pages 688-689, Morden J.A. concluded that a *pro rata* distribution based on tracing is "workable" and, as such, ought to be the "general rule":

> While acknowledging the basic truth of Lord Atkin's observation that "convenience and justice are often not on speaking terms" (*General Medical Council v. Sprackman* (1943) A.C. 627 at p. 638), I accept that convenience, perhaps more accurately workability, can be an important consideration in the determination of legal rules. A rule that is in accord with abstract justice but which, for one or more reasons, is not capable of practical application, may not, where larger considerations of judicial administration are taken into account, be a suitable rule to adopt. However, I am not persuaded that considerations of possible inconvenience or unworkability should stand in the way of the acceptance, as a general rule, a *pro rata* sharing on the basis of tracing. That it is sufficiently workable to be the general rule is indicated by the fact that it appears to be the majority rule in the United States (See Scott, *The Law of Trusts*, Vol. 5, 3rd edition (1967) pp. 3639-41; J. F. Ghent, *Distribution of Funds Where Funds of More Than One Trust Have Been Commingled by Trustee and Balance is Insufficient to Satisfy Act Trust Claims* (Annotation) (1968), 17 A.L.R. (3d) 937) and has been adopted in the Restatement of the Law: Trusts (2nd) (s. 202) and the *Restatement of Restitution* (s. 213).

[64] In addition, Morden J.A. references Scott, *The Law of Trusts*, which expressly approves the analysis of Judge Learned Hand, discussed above.

[65] Counsel goes on to point out, however, that the court in *Greymac* recognized that certain exceptional situations are so complicated that *pro rata* division on the basis of tracing cannot be undertaken. Quoting from a journal, Morden J.A. observed, at page 689:

> Naturally, the number of accounts, investments and transactions can be multiplied to a point where calculations become too complicated and expensive to undertake.

[66] In these circumstances, Morden J.A. suggested that a *pro rata* distribution based on total claims (or original contributions) is better than the rule in Clayton's Case:

> I might add that it may well be that proportionate sharing on the basis of the claimant's original contributions (that is, not on the basis of tracing) may be just as convenient or, possibly, more convenient than the application of the rule in Clayton's Case and, also, fairer.

[67] Concluding on this point, counsel submits that Morden J.A. adopted *pro rata* on the basis of tracing (or LIBR) as the "general rule" and *pro rata ex post facto* as the exception. Counsel further submits that Morden J.A. explained that *pro rata ex post facto* ought to be used when it was not "practically…possible" to divide a fund *pro rata* based on tracing.

[68] Counsel to Gibson concludes by submitting that the decision of Morden J.A. that *pro rata* based on tracing (or LIBR) is the "general rule" is binding because the Supreme Court of Canada affirmed *Greymac* on appeal and expressly adopted "the reasons therefore delivered by Morden J.A. on behalf of the court".

LAW AND ANALYSIS

[69] Both parties argue that *Greymac* suggests their position. I disagree. I have concluded that the reasoning in *Greymac* aligns with the position put forth by Gibson.

[70] *Greymac* is the controlling authority and, given the submissions of Waldock, must be contrasted with the decision in *Law Society*.

[71] In *Law Society*, the issue before the court was how to distribute the funds in the comingled account and whether the bank should be able to claim priority with a *pro rata* distribution based on tracing (the court in *Law Society* referred to this as LIBR).

[72] The court in *Law Society* found against the bank and concluded that distribution on the basis of *pro rata ex post facto* was appropriate.

[73] The result in *Law Society* is consistent with the result in *Greymac*. Morden J.A. acknowledged in *Greymac* that, in circumstances where *pro rata* on the basis of tracing (LIBR) is not practically possible, distributions should proceed on a *pro rata ex post facto* basis. The court in *Law Society*, at page 271, determined that it was not "practical" to undertake a tracing exercise in the circumstances of that case:

> There are over 100 claimants. There were misappropriations in the area of $900,000 in bits and pieces. It is not even clear that each deposit and debit can be looked at individually, on the state of the record... It is not at all clear on the evidence that this exercise can be done.

[74] *Law Society* expressly rejected the rule in Clayton's Case. The court then considered *Greymac*, but arrived at the conclusion that it was not practical to apply *pro rata* tracing on the facts of *Law Society*. Blair J. (*ad hoc* at the time) found, in *Law Society*, at page 267: "In my view, however, this approach is too complex and impractical to be accepted as a general rule for dealing with cases such as this".

[75] Blair J. went on to state, at page 269: "although LIBR may be "manifestly fairer" in the pure sense of a tracing analysis, it is manifestly more complicated and more difficult to apply than other solutions".

[76] Given the statements in *Law Society*, and the fact that *Law Society* follows *Greymac*, it is necessary to consider the statements of Blair J. in *Law Society* in the context of the decision. In doing so, it seems to me that there is no direct contradiction between the two decisions.

[77] At the outset of *Law Society*, Blair J. introduces the case: "It raises issues concerning what is known as "the rule in Clayton's Case" and a descendant concept called "the lowest intermediate balance rule" (frequently referred to by the acronym "LIBR")".

[78] At part 2 of his decision, entitled "Law and Analysis", Blair J. references the following subheading: "A Consideration of 'The Rule in *Clayton's Case*' and the 'Lowest Intermediate Balance Rule'".

[79] His overview of this section, at page 261, states:

> The bank's attempt to invoke the lowest intermediate balance rule in the circumstances of this case amounts to nothing more, in my opinion, than an attempt to reinvoke the rule in Clayton's Case, which was rejected by this court and by the Supreme Court of Canada in *Ontario (Securities Commission) v. Greymac Credit Corp., supra.* The effect of applying the "lowest intermediate balance rule" to the competing claims of the trust fund beneficiaries is to permit the bank – the last contributor – to recover what for practical purposes is all of its deposits, exactly the result which would transpire upon the application of the rule in Clayton's Case. I do not think that result is called for in the circumstances of this case.

[80] At page 262, Blair J. went on to state:

> Speaking for a unanimous court in *Greymac*, Morden J.A. resolved that as a general rule the mechanism of *pro rata* sharing on the basis of tracing was the preferable approach to be followed, although he left room for other possibilities such as those circumstances where it is not practically possible to determine what proportion the mixed funds bear to each other, or where the claimants have either expressly or by implication agreed among themselves to a distribution based otherwise than on a *pro rata* division following equitable tracing of contributions (pp. 685-90). Whatever approach was chosen, Morden J.A. was concerned that it should be one which met the test of convenience – or "workability", as he termed it (p. 688). The core of the court's conclusions is to be found in the following passage from its judgment at p. 685:
>
> > The foregoing indicates to me that the fundamental question is not whether the rule in Clayton's Case can properly be used for tracing purposes, as well as for loss allocation, but, rather, whether the rule should have any application at all to the resolution of problems connected with competing beneficial entitlement to a mingled trust fund where there had been withdrawals from the fund. From the perspective of basic concepts, I do not think that it should. The better approach is that which recognizes the continuation, on a *pro rata* basis, of the respective property interests in the total amount of trust monies over property available.
>
> Having determined that the rule in Clayton's Case ought not to be applied in cases involving the claims of competing trust beneficiaries, Morden J.A. concluded in *Greymac* that *pro rata* sharing based on the respective property interests of the claimants and the total amount of trust money or property available, should be applied. He accepted such *pro rata* sharing as the general method of determining such competing interests. Whether, as some have suggested, he also recognized and incorporated into the *pro rata* sharing exercise the concept of the lowest intermediate balance rule, and if so to what extent, is an issue that will be dealt

with momentarily. First, however, I propose to turn to an analysis of the history and application of the LIBR notion.

[81] From the above, I discern the following:

(i) The controlling authority, *Greymac*, clearly rejects the rule in Clayton's Case as unfair, arbitrary, and based on a fiction.

(ii) The court in *Greymac* held that, as a general rule, the mechanism of *pro rata* sharing based upon tracing (or LIBR) was the preferable approach to resolving competing claims to mingled trust funds.

(iii) In *Law Society*, the outcome is consistent with *Greymac*. At page 271, Blair J. states:

> In this case, it is not practicable to conduct the LIBR exercise. There are over 100 claimants. There were misappropriations in the area of $900,000 in bits and pieces. It is not even clear that each deposit and debt can be looked at individually, on the state of the record, although the total amounts deposited by each of the claimants are apparently known. Notwithstanding this, if the LIBR principle is to be applied to a *pro rata* distribution in the circumstances of this case, it would be necessary to consider not only the deposits of each individual claimant and the timing of such deposits, but also what was the lowest balance in the Upshall account between each deposit and the imposition of the freeze. This would involve analyzing the pattern and timing of each misappropriation and applying the results to each individual deposit or circumstances. It is not at all clear, on the evidence, that this exercise can be done.

(iv) The finding in *Law Society* as expressed above falls within the exception provided for in *Greymac*. In essence, the general rule as stated by Morden J.A., could not, in the view of Blair J., be applied in the circumstances of *Law Society*. The court in *Law Society* spent considerable time addressing the parameters and practical application of LIBR. However, this analysis has to be considered in the context of the conclusion reached by Blair J. as set out at page 271, namely, "In this case, it is not practicable to conduct the LIBR exercise".

[82] There is no doubt that the issues, terms and concepts discussed at length in both *Greymac* and *Law Society* are complex. As noted by Blair J., at page 267, in reference to the British Columbia Law Reform Commission in its "Report on Competing Rights to Mingled Property: Tracing and the Rules in *Clayton's Case*" (1983), terms like "*pari passu*", "*pro rata*", "rateably", and "proportionally" are inherently ambiguous. To this list of terms can be added, "LIBR", the "rolling charge", and the "North American" approach. It seems to me that these terms have not always been used with precision and, as a result, considerable confusion has arisen in the cases.

[83] A further example of the issue is set out in *Graphicshoppe*. Writing for the majority, Moldaver J.A. (as he then was) at para. 126 and following stated:

> 126. ...the reasoning in *Law Society* as it relates to the issue of how best to allocate the funds remaining in a mixed trust account between competing beneficiaries simply has no application to this preliminary question. The same thing can be said about the reasoning in *Greymac*, which, like the reasoning in *Law Society*, focused on the resolution of beneficiaries' competing proprietary claims to the remaining trust funds.
>
> 127. I would also add that throughout his reasons for judgment in *Law Society*, Blair J. (*ad hoc* at that time) clearly acknowledged that the issue before the court was confined to determining the best approach for resolving the claims of competing beneficiaries to funds remaining in a mixed trust account. Blair J. considered the *pari passu ex post facto* approach to be the best approach for that task because of the inconvenience that is often associated with having to apply the lowest intermediate balance rule [or *pro rata* on the basis of tracing] in cases involving any significant number of beneficiaries in transactions, and because of the nature and purpose of the mixed trust fund. In Blair J.'s view, such a fund is in many ways a mechanism of convenience, in that it avoids the necessity, cost and cumbersome administrative aspects of having to set up individual trust accounts for each beneficiary. Blair J. reasoned that "a mixed fund of this nature should be considered as a whole fund, at any given point in time, and that the particular moment when a particular beneficiary's contribution was made and the particular moment when the defalcation occurred, should make no difference".

[84] This passage from *Graphicshoppe* confirms that in *Law Society* Blair J. determined the *pro rata ex post facto* approach to be the best approach in that case because of the inconvenience that is often associated with having to apply LIBR in cases involving any significant number of beneficiaries and transactions, and because of the nature and purpose of the mixed trust fund. In my view, neither *Law Society* nor *Graphicshoppe* stand for the proposition that LIBR is not to be utilized when circumstances are such that it can be. Rather, consistent with *Greymac*, the general rule is that LIBR should be applied unless it is unworkable. As Morden J.A. stated in *Greymac*, at page 688: "I am not persuaded that considerations of possible inconvenience or unworkability should stand in the way of the acceptance, as a general rule, of *pro rata* sharing on the basis of tracing [or LIBR]".

[85] In *Graphicshoppe*, the decision involved trust claims of employees to a mixed fund. In dissent, Juriansz J.A. followed the analysis of Blair J. in Law Society and expressly rejected "the logic of the LIBR".

[86] However, Moldaver J.A., writing for the majority, did not agree with Juriansz J.A.'s "analysis or conclusions". In arriving at his decision, Moldaver J.A. applied LIBR: "...it is clear from the record that as of the date of bankruptcy, none of the employee contributions that had been deposited into *Graphicshoppe*'s bank account remained intact. We know that with certainty because prior to the date of bankruptcy, the account went into negative balance".

[87] Justice Moldaver distinguished *Law Society* on its facts and also addressed the role of LIBR. After citing Lionel Smith's article, Moldaver J.A. stated:

> I recognize that my colleague Juriansz J.A. says that this argument is simply an attempt to apply the logic of the lowest intermediate balance rule. With respect, assuming that characterization is correct, I do not see how applying this logic can be erroneous, when in this case, it is solidly supported by the facts.

[88] Thus, it seems to me that although the Court of Appeal for Ontario did not, on the facts, apply LIBR in *Law Society*, it was accepted by Moldaver J.A. in *Graphicshoppe*. Thus, by virtue of the Supreme Court of Canada's affirmation of *Greymac* and the more recent decision in *Graphicshoppe*, LIBR is an available mechanism to distribute comingled funds.

[89] The controlling authority, *Greymac*, directs, in my view, that *pro rata* sharing based on tracing (LIBR) is the "general rule" that ought to be applied in this case unless it is practically impossible to do so.

[90] In the present case, I accept the uncontroverted evidence of the Receiver that all steps have been taken to establish that LIBR calculations can be made. As such, the general rule as set out in *Greymac* must be applied in this case.

[91] In my view, the application of the general rule as set out in *Greymac* produces a result that I consider to be just and equitable. Morden J.A. recognized that the principles of "logic, justice and convenience" govern in circumstances such as these (see *Greymac* at page 680). Blair J. in *Law Society* also noted that "the court should therefore seek to apply the method which is the more just, convenient and equitable in the circumstances" (see *Law Society* at page 269).

[92] On the facts of this case, justice dictates that the funds should be distributed proportionately based on the interests of the parties at the time of comingling; the Receiver's fund unit allocation method (or LIBR). A *pro rata ex post facto* distribution would not result in a fair outcome where a very small number of individuals, including Waldock, had invested a significant amount of money early on in the lifespan of the fund. By the time of Gibson's investment, the evidence is clear that these early investors had lost over 88% of their investment value.

[93] In this case, the practical concerns cited in *Greymac* do not exist. The Receiver has determined a practicable method for distributing the Greyhawk Fund *pro rata* on the basis of LIBR. The Receiver has confirmed that it had the necessary information to complete its calculation accurately.

[94] Waldock raises the issue, at paragraph 9 of the Reply Factum, that the evidence of the Receiver is that it would be impossible to trace the various investments and transactions that occurred in this case. The Receiver has determined that it cannot trace or match trades and securities to specific investors as investor funds were comingled over a lengthy period. To further complicate matters, the Receiver has confirmed that it is not possible to match any particular sale of securities to a corresponding redemption. However, there is no evidence to suggest that the Receiver would need to be able to do these things in order to properly calculate distributions using the fund unit allocation method (LIBR). Rather, as noted previously at [36],

the evidence of the Receiver is that it has been able to make these calculations in spite of the challenges noted by Waldock.

DISPOSITION

[95] For the foregoing reasons, I direct that distributions be made pursuant to the fund unit allocation method (or *pro rata on the basis of tracing*, or LIBR).

[96] In recognition of the fact that this issue had to be determined prior to any distribution and given that both Waldock and Gibson were victims of a fraud, it is appropriate that the costs of the parties be paid out of the assets of the Greyhawk Fund.

[97] I thank counsel for their very helpful submissions on this matter.

MORAWETZ J.

Date: July 16, 2012