

Eron Mortgage Corp. (Trustee of) v. Eron Mortgage Corp.

Between
Eron Mortgage Corporation, in its capacity as Trustee, and
others, petitioners, and
Eron Mortgage Corporation, Her Majesty the Queen in Right of
the Province of British Columbia, Eron Financial Services
Limited and all investors as set out in Schedule "A" attached
to the petition, respondents

[1999] B.C.J. No. 347
70 B.C.L.R. (3d) 381
10 C.B.R. (4th) 257
86 A.C.W.S. (3d) 263
Vancouver Registry No. A972569

British Columbia Supreme Court
Vancouver, British Columbia
Tysoe J.

Heard: February 4 and 5, 1999.
Judgment: filed February 17, 1999.
(24 pp.)

Trusts — Creation of trust — Requirements — Certainty of subject matter of trust — Transactions creating trusts — Money advanced for loan purposes — Termination of trusts — Distribution of property.

Hearing to determine questions relating to the method of distribution of assets under the control of the Judicial Trustee. Eron carried on the business of a mortgage broker. It arranged for numerous investors to pool their funds for the purpose of making a single loan to a borrower. The mortgage or other security was taken in the name of Eron which signed a declaration that it held the security for the investors. The investors were asked to choose a particular loan in which to participate. Eron administered the loans on behalf of the investors and made monthly interest payments to the investors. Typically, Eron gave an investor several choices of financing opportunities. The investors would receive a term sheet in return for their funds. The heading of the term sheet identified the borrower and the amount of financing. In signing the term sheet, the investors agreed to the terms under which they were participating, including the amount of principal advanced by them, the interest rate, the term of the participation and the amount of the monthly payments. The term sheet also contained a description of the security taken in respect of the loan. The investors' funds were normally collected in a Pooled Trust Account from which Eron advanced the loans. There were, however, other methods by which funds were collected from investors. Approximately 25 of the loans

utilized separate bank accounts in a name of the numbered company which was used to hold the security for the investors. Often the investors would make their cheques payable to Eron, which deposited them into the Pooled Trust Account and then forwarded a like amount from the Pooled Trust Account to the separate bank account. A number of investors invested their funds through a registered retirement savings plan. Some investors advanced their funds to their legal counsel for Eron. The funds were generally released when it was acknowledged that the investor was participating in the loan. Various forms of undertaking were imposed in connection with the release of the funds. Finally, in some cases an investor would replace an existing investor. When Eron had its mortgage broker's licence suspended and ceased to carry on business, Judicial Trustees were appointed in respect of the security over which Eron had been trustee. The principal Judicial Trustee was directed to prepare a report providing information to assist the court in determining the appropriate scheme of distribution to the investors. This hearing was held to answer a series of questions relating to the method of distribution posed by the report.

HELD: Judicial Trustee directed to distribute the monies recovered on each mortgage in accordance with the trust declarations relating to the mortgage irrespective of the account into which the investors' funds were deposited. In the typical case where Eron or its numbered company issued a declaration of trust after it had taken security and advanced the loan to the borrower, valid trusts were created as there was sufficient certainty of intention, subject matter and objects. Tracing of investors funds from the Pooled Trust Account to the loan made to the borrower was not necessary in order to create a trust. In the cases where no such declaration was issued, the principal Judicial Trustee would have to assess whether a trust was created. The intention of the parties when they entered into the transactions was that the investors would have an interest in the mortgage loan they selected and that all investors would not stand on the same footing. There was no equitable reason to deprive them of their choices. Equality among investors in this case would constitute an inequity because it would represent a variation of the contracts and trust arrangements between Eron and the investors without proper justification at law or in equity.

Counsel:

Allan P. Seckel, for PricewaterhouseCoopers Inc., Judicial Trustee in respect of all Eron investments except the Fort McMurray investment.

Peter C. Lee, for Manning Jamison Ltd., Judicial Trustee in respect of the Fort McMurray investment.

David A. Hobbs, for investors Eron Mortgage Corporation favouring pooling.

David G. Fredricksen, for investors in Eron Mortgage Corporation opposed to pooling.

Bruce B. Clark, for certain investors claiming an interest in the Fort McMurray investment.

Karen S. Thompson, for certain investors claiming an interest in the Gateway investment.

Various investors on their own behalves.

¶ 1 **TYSOE J.**— Eron Mortgage Corporation ("Eron") ceased carrying on business on October 3, 1997 when the Registrar of Mortgage Brokers suspended its mortgage broker's

licence and I appointed Price Waterhouse Limited (now Pricewaterhouse-Coopers Inc.) as Judicial Trustee in respect of security over which Eron or its related companies had been trustee. Manning Jamison Ltd. subsequently became Judicial Trustee in respect of one of the Eron mortgages covering a commercial building located in Fort McMurray.

¶ 2 The issues presently before the Court relate to the distribution of the assets under the control of the Judicial Trustees to the investors who provided funds to Eron (or numbered companies incorporated by it) for investment in loans arranged by Eron. The subject issues were not considered to be in question until the hearing of a distribution issue last June involving one of the related companies, Eron Investment Corporation, when the decision in *Holden Financial Corp. v. 411454 Ontario Ltd.* [See Note 1 below] was relied upon in support of the position that funds in Eron Investment Corporation should be pooled and distributed to investors on a pro rata basis. Until that time, the Judicial Trustees had been acting on the basis that funds collected on a loan would be distributed to those investors who had contracted with Eron Mortgage Corporation to participate in that loan. The *Holden Financial* case raised the issue of whether the ability of the investors to trace their funds to the loans in which they intended to participate would make a difference to the method of distributing the monies recovered by the Judicial Trustees on the loans.

Note 1: *Holden Financial Corp. v. 411454 Ontario Ltd.*, [1992] O.J. 1783 (Q.L.) (Ont. Gen. Div.), overturned in part [1993] O.J. 3048 (Q.L.) and affirmed in part [1993] O.J. 3999 (Q.L.) (Ont. C.A.).

¶ 3 By Reasons for Judgment issued on July 13, 1998 [See Note 2 below], I ordered that all investors who had advanced monies to Eron Investment Corporation should be pooled and should share on a pro rata basis in the assets of Eron Investment Corporation. In making my ruling I followed the approach taken by the Manitoba Court of Appeal in *Re Winnipeg Mortgage Exchange Ltd.*, [See Note 3 below] which I preferred over the reasoning in *Holden Financial*. In addition, I appreciated the potential impact of *Holden Financial* on the distribution of the recoveries on loans made through Eron Mortgage Corporation and I did not want to make a ruling in connection with Eron Investment Corporation which could affect all of the remaining Eron investors without giving them an opportunity to be heard.

Note 2: Now reported at (1998), 2 C.B.R. (4th) 184.

Note 3: *Re. Winnipeg Mortgage Exchange Ltd.* (1982), 43 C.B.R.(N.S.) 119 (Man. C.A.).

¶ 4 On September 11, 1998 I directed PricewaterhouseCoopers Inc., the principal Judicial Trustee, to prepare a report providing information to assist the Court in determining the appropriate scheme of distribution to the Eron investors. The report was issued in December 1998 and it posed 40 sets of questions relating to the method of distribution. At a hearing on December 18, 1998, after counsel were appointed pursuant to my direction to represent the two main points of view, I ordered that there be a hearing for the determination of six of the 40 sets of questions. Counsel agreed that many of the remaining 34 sets of questions could be resolved easily once these six sets of questions were answered and that it would be too cumbersome to attempt to deal with all 40 sets of questions at one hearing. These six sets of questions relate to

the main pooling issue and I will set them out after I have reviewed Eron's factual background (which is derived from the report of the principal Judicial Trustee or statements by counsel for the principal Judicial Trustee).

BACKGROUND FACTS

¶ 5 Eron carried on the business of a mortgage broker. The traditional function of a mortgage broker is to match up one borrower with one lender. The lender makes a loan to the borrower on the security of a mortgage against real estate granted by the borrower to the lender. The mortgage broker is paid a brokerage fee by the lender and often has no other involvement. The borrower makes the payments due on the mortgage directly to the lender (unless the mortgage broker has agreed to administer the mortgage on behalf of the lender).

¶ 6 Eron took the role of mortgage broker to a more sophisticated level. It acted as broker for large syndicated loans. It arranged for numerous lenders (or investors) to pool their funds for the purpose of making a single loan to a borrower. The borrowers were usually developers of commercial real estate. The loan was funded through Eron or a numbered company which Eron incorporated for this purpose. The mortgage or other security was taken in the name of Eron, or the numbered company, which signed a declaration stating that it held the security for the investors. Eron administered the loans on behalf of the investors and made monthly interest payments to the investors. Approximately 4,000 people invested monies through Eron and its related companies in this fashion. At the time Eron's mortgage broker's licence was suspended, there were 76 outstanding loans with financing provided by Eron's investors in the aggregate of approximately \$222 million.

¶ 7 Eron typically gave an investor several choices of financing opportunities. It gave each potential investor a "hot sheet" for each of several projects giving details such as the proposed mortgage amount, term of the loan, rate of return and value of the project. The investors did varying degrees of due diligence with respect to the proposed loan. In some cases the investor did nothing more than pick from the various "hot sheets" provided by Eron. In other cases the investor viewed the properties and requested additional information from Eron. In all cases involving investment through Eron (as distinct from Eron Investment Corporation) the investor was requested to choose a particular loan in which to participate.

¶ 8 Once an investor had decided to participate in a loan, the investor provided his or her funds in return for a term sheet. The heading of the term sheet identified the borrower and the amount of the financing. In signing the term sheet, the investor was agreeing to participate in the loan which was acknowledged to be a syndicated loan. The investor agreed to the terms under which he or she was participating - those terms usually included the amount of principal advanced by the investor, the interest rate, the term of the participation and the amount of monthly payments. The term sheet also contained a description of the security to be taken in respect of the loan.

¶ 9 As the loans were syndicated, it was necessary for Eron to collect all of the funds from the investors and to then advance the loan to the borrower. The funds were normally collected in an account which Eron maintained with Bank of Montreal. The account was denoted as a trust account on the bank statements and Eron did not deposit any of its general funds into the account. There was not a separate account for every loan and funds relating to many of the loans

were deposited and withdrawn from this account, which I will refer to as the "Pooled Trust Account" (there was a separate account for U.S. dollar investments, which I will refer to by the same term for the sake of convenience).

¶ 10 The other methods by which funds were collected from investors are as follows:

1. Approximately 25 of the loans utilized separate bank accounts in the name of the numbered company which was used to hold the security for the investors. The funds were collected from the investors and deposited into the separate account, and the loan was then advanced to the borrower from the account. However, investors often made their cheques payable to Eron, which deposited them into the Pooled Trust Account and then forwarded a like amount from the Pooled Trust Account to the separate bank account.
2. A number of investors wanted to invest funds in their registered retirement saving plans ("RRSP") and this was done through Laurentian Bank of Canada. Laurentian established an RRSP account for the investor and forwarded the monies to a lawyer. The lawyer did one of three things with the monies: (i) he or she advanced it as part of the loan to the borrower; (ii) he or she caused it to be deposited into the separate account of the numbered company, from which it was then advanced to the borrower; and (iii) he or she provided it to Eron which deposited it into the Pooled Trust Account. Sometimes the investor made his or her cheque payable to Eron, which deposited the cheque into the Pooled Trust Account and then sent a cheque in like amount to Laurentian.
3. Some investors advanced their funds to their own lawyer or Eron's legal counsel. The funds were generally released when it was acknowledged that the investor was participating in the loan. Various forms of undertaking were imposed in connection with the release of the funds.
4. An investor sometimes participated in a loan by replacing an existing investor. The incoming investor advanced his or her monies directly to the outgoing investor. In other cases, despite the absence of replacement investors, existing investors were paid out by Eron prior to the expiry of their terms or were allowed to transfer to other loans.

¶ 11 After the loan was funded to the borrower and the security was taken in the name of Eron or one of its numbered companies, Eron would typically send to the investors a declaration or a declaration of trust stating that Eron or the numbered company held the security as agent for the use, benefit and advantage of the investors (who were listed on a schedule) as tenants-in-common in accordance with the interests as set forth in the schedule or as determined by the amount of principal advanced by each investor as set out in the schedule. The amounts stated in the declaration would generally conform to entries made in project ledgers maintained by Eron in respect of each of the loans. The declaration stated that Eron or the numbered company could only deal with the security in accordance with a majority vote of the investors (determined by dollar value).

¶ 12 Several deficiencies have been noted by the principal Judicial Trustee with respect to the declarations. One example is that declarations were not always completed for a loan. Another example is that the declarations were not always updated when an investor was paid out and replaced by another investor.

¶ 13 The reason giving rise to the potential applicability of Holden Financial is that Eron committed many breaches of trust with respect to the Pooled Trust Account. The first breach occurred a very short time after the account was opened in 1993. The nature of the breaches of trust included the following:

- (a) most of Eron's loans were non-performing in the sense that the borrower was not making the stipulated monthly interest payments and Eron made monthly interest payments to the investors from the Pooled Trust Account (i.e., from monies contributed by other investors in respect of other loans);
- (b) loan advances were made to a borrower before the necessary funds had been collected from the investors in respect of that loan (which meant that the loan was being partially funded with monies contributed by investors in respect of other loans);
- (c) investors were paid out from monies in the Pooled Trust Account when no replacement investor had been found; and
- (d) expenses such as brokerage and legal fees, which are normally payable by the borrower, were paid from monies in the Pooled Trust Account.

¶ 14 Eron loans were both underfunded and overfunded. They were underfunded in the sense that the amount of the loan advanced to the borrower exceeded the amount collected from investors in respect of that loan. The difference was made up from monies collected from investors in respect of other loans. Loans were overfunded in the sense that Eron collected more monies from investors in respect of a loan than the amount advanced to the borrower. These excess funds were used by Eron for other purposes, primarily the payment of interest to investors in respect of other non-performing loans.

¶ 15 The loans outstanding at the time of the suspension of Eron's mortgage broker's licence do not appear to have been very prudently made. Some of the loans will be repaid in full but there will be little, if any, recovery on many of the loans. It is presently estimated that of the \$222 million invested through Eron, approximately \$40 million will be recovered. The return to the individual investors will range from 0% to 100% unless all of the investors are pooled and the distribution to them is made on a pro rata basis.

ISSUES

¶ 16 The six sets of primary questions posed in the report of the principal Judicial Trustee are as follows:

1. Prima facie, are the investors whose funds were deposited to the Pooled Trust Account entitled to (or limited to) a return on their advance based on the recovery on the specific mortgage to which their advance was credited

in the project ledger, or are all proceeds from projects that received funds from the Pooled Trust Account to be pooled and paid pro rata to all investors regardless of the term sheet they received or the accounting in the project ledgers?

2. Prima facie, are the investors whose funds were deposited directly to the separate accounts maintained by the trustees of the security entitled to (or limited to) a return on their advance based on the recovery of the specific mortgage? Do these investors rank in priority to investors who advanced their funds to the Pooled Trust Account?
3. Prima facie, are the RRSP investors whose funds were forwarded to Laurentian, along with project-specific lists, entitled to (or limited to) a return on their advance based on the recovery on the specific mortgage?
4. Are RRSP investors whose funds were initially deposited into the Pooled Trust Account or separate accounts maintained by the trustees of the security entitled to (or limited to) a return on their advance based on the recovery of the specific mortgage?
5. Prima facie, are the investors whose funds were advanced by their own legal counsel directly to the project with their advances being recorded on the project ledger entitled to (or limited to) a return on their advance based on the recovery on the specific mortgage?
6. Prima facie, are the investors who by a direct payment to another investor in substitution for their own advance to a project entitled (or limited to) a return on their advance based on the recovery on the specific mortgage? Do the new investors assume the priority of the investor they replaced?

DISCUSSION

¶ 17 Counsel made more detailed submissions and relied upon more authorities than was the case at the hearing involving Eron Investment Corporation. Briefly stated, Mr. Hobbs advocated pooling on the basis of the authority of Holden Financial and other decisions, and he also took the position that no valid trusts were created in favour of the investors. Mr. Fredricksen opposed pooling on the basis that the trusts were valid and that the reasoning in Holden Financial was in error. The other counsel all supported the position of Mr. Fredricksen and made additional arguments against pooling.

(a) Validity of the Trusts

¶ 18 Mr. Hobbs challenged the validity of the trusts claimed by the investors over the Eron mortgages. If there are no valid trusts of the mortgages created by the documentation issued by Eron or its numbered companies, there would have to be pooling of the loan recoveries unless investors are able to trace their funds into particular investments. Mr. Hobbs submitted that all funds which were deposited into the Pooled Trust Account cannot be traced as a result of Eron's breaches of trust.

¶ 19 It is common ground that three essential elements of a trust are (i) certainty of intention, (ii) certainty of subject matter and (iii) certainty of objects. In my view, all three elements were satisfied in the typical case where Eron or its numbered company issued a declaration or declaration of trust after it had taken the security and advanced the loan to the borrower. In the cases where no such declaration was issued, the principal Judicial Trustee will have to assess whether a trust was created and, if necessary, it may apply to Court for further directions in that regard.

¶ 20 Mr. Hobbs effectively conceded that it was the common intention of Eron (or its numbered company) and each investor that Eron (or its numbered company) would hold an interest in the mortgage or other security in trust for the investor. Huband J.A. discussed the requirement for certainty of intention at length in his dissenting judgment in Winnipeg Mortgage and he concluded in similar circumstances that there was an intention to create trusts. Although the majority in Winnipeg Mortgage decided to disregard the trusts and to pool all of the mortgage assets because the allocation of the mortgages to the investors was arbitrary, the majority did not disagree with the general principles relied upon by Huband J.A. with respect to the creation of trusts.

¶ 21 Mr. Hobbs submitted that there was no certainty of subject matter because (i) the term sheets were not sufficiently specific in identifying the security to be held in trust and (ii) one of the forms of trust declaration stated that the interest of each investor was to be based on the principal funded by them and the breaches of trust by Eron in the operation of the Pooled Trust Account prevented any investor whose money was deposited into the Pooled Trust Account from proving that their money was advanced to the borrower.

¶ 22 I agree that there were deficiencies in the term sheets. However, the trusts were created by the trust declarations, not the term sheets. The mortgages and other security were sufficiently described in the trust declarations. Typically, the mortgage was described by reference to the legal description of the mortgaged property and the number under which the mortgage was registered in the appropriate Land Title Office.

¶ 23 The initial trust declaration generally contained an accurate list of the investors who were to be beneficiaries of the trust, and the trust was validly created at the time the trust declaration was issued. The entire trust was not made invalid as a result of the fact that some investors were paid out and other investors joined in the loan. There may be issues as to whether subsequent investors became beneficiaries of the trust, particularly when a loan was overfunded, but these issues will not cause the trust to become invalidated.

¶ 24 Although it is unlikely that many, if any, of the investors whose funds were deposited into the Pooled Trust Account will be able to trace their monies to the loan made to the borrower, such tracing is not required in order to create a trust. I will discuss this issue in greater detail when I deal with the decision in Holden Financial. Further, the schedule to the trust declaration set out the amount funded by each investor and it is possible to ascertain the interest of each investor by referring to the amounts set out in the schedule.

¶ 25 Mr. Hobbs submitted that there was no certainty of objects because the trust beneficiaries cannot be ascertained with certainty. In some cases the trust declaration was updated each time an investor was paid out and a new investor took his or her place. However,

in many cases, the trust declarations were not updated as the investors changed. In addition, many of the loans were overfunded, with the aggregate amount collected from investors in respect of the loan exceeding the sum advanced on the loan to the borrower.

¶ 26 In Law of Trusts in Canada, [See Note 4 below] the author discusses the requirement for the certainty of objects:

Note 4: D.W.M. Waters, Law of Trusts in Canada, 2d ed. (Toronto: Carswell, 1984).

Persons, human or incorporated, are the familiar objects of trusts, and the problem of certainty which they present is whether it is possible to say that the persons intended as objects are ascertainable. Ascertainable is a somewhat ambiguous word, but in this context it means two things: first, that it is possible to determine, if the intended beneficiaries are not referred to by name but by a class description, whether any person is a member of that class, and, secondly, that the totality of the membership of that class is known. Ascertainment means certainty, and it is certainty on both those matters that must be established if the trustees have no discretion as to distribution among the class members, but hold the property for beneficiaries who have interests whose amount or quantum is set out in the instrument creating the trust. (pp. 122 - 3)

¶ 27 The topic is also discussed in Law Relating to Trusts and Trustees: [See Note 5 below]

Note 5: Underhill and Hayton, Law Relating to Trusts and Trustees, 14th ed. (London: Butterworths, 1987).

A fixed trust is void unless at the outset it can be seen clearly that all the beneficiaries thereunder are then ascertainable or will be ascertainable when the time comes under the trust to distribute capital or income. Just as a trust for A for life remainder to B absolutely is valid, so is a trust for A (a bachelor) for life remainder to his children equally and a trust to divide a fund equally between such persons as shall on X's death be his statutory next of kin or his dependants. However, a trust to divide a fund equally between next of kin and dependants of persons currently or formerly employed by ICI Ltd or by any company on the board of which an ICI Ltd director currently sits will be void unless a comprehensive list of such beneficiaries can be drawn up so as to enable an equal division to be made. Except where the potential number of beneficiaries is very high and the value of the trust fund relatively low it will usually be possible to draw up a comprehensive list of the persons ranking as beneficiaries at the time for distribution of the trust fund. (pp. 46 - 7)

¶ 28 In the present case, the beneficiaries are ascertainable. The Judicial Trustees have prepared lists for all of the loans showing the investors for each loan based on documentation in Eron's records. This is not a situation where the beneficiaries are named by a class description which is uncertain. Here, the beneficiaries were listed in schedules to the trust declarations with the result that the beneficiaries were ascertainable when the trust was created. Despite the fact

that the trust declarations were often not updated when investors were changed or added, the Judicial Trustees believe that they have been able to ascertain all of the beneficiaries at the present time. While there may be some issues which will have to be resolved regarding the identity of beneficiaries, they will not be sufficiently insurmountable so as to make the beneficiaries unascertainable.

¶ 29 As there is sufficient certainty of intention, subject matter and objects, I find that the trusts created by the declarations are valid unless there is an overriding equitable principle which should cause the Court to disregard the trusts.

(b) Equitable Considerations

¶ 30 In support of his argument for pooling, Mr. Hobbs relied on the general principles of equitable tracing discussed at length in *Re Diplock* [See Note 6 below] and other authorities dealing with situations which have some resemblance to the present case. Mr. Fredricksen countered that the law of tracing is not relevant to the issue of pooling in this case and that the Court should not interfere with the trusts established by Eron and its numbered companies.

Note 6: *Re Diplock*, [1948] Ch. 465 (Eng. C.A.).

¶ 31 In *Holden Financial*, Rosenberg J. based his decision in favour of pooling on the inability of the investors to trace their funds. *Holden Financial* was a mortgage broker which held mortgages for its investors. The vast majority of investors left the investment of their funds entirely with *Holden Financial* and played no part in selecting mortgages allocated to them; nor did they receive any documentation evidencing an allocation of their investment to any particular mortgage. However, one investor, a Mr. Harnden, did play an active role in the selection of the mortgages in which his funds were to be invested. He inspected the property to be mortgaged and made his own risk assessment before agreeing to invest. Three mortgages related to Mr. Harnden. One was registered directly in his name and was considered to fall outside of *Holden Financial's* trust assets. The second mortgage was registered in the name of *Holden Financial* in trust for Mr. Harnden. The third mortgage was registered in the name of *Holden Financial* with no reference to Mr. Harnden.

¶ 32 Rosenberg J. stated that Mr. Harnden had the strongest case of all of the investors. However, as funds were improperly removed from *Holden Financial's* trust account between the time Mr. Harnden's funds were deposited into the account and the time the mortgage transaction was closed, Mr. Harnden was not able to trace his funds to the investments in question. Rosenberg J. concluded that it was necessary for Mr. Harnden to trace his funds to the investments in order to have a valid trust and that, as neither Mr. Harnden nor any other investor could trace their funds, the "trust assets" of *Holden Financial* were to be treated as being acquired by a single common fund and should be distributed on a pro rata basis among the investors. The reasoning of Rosenberg J. was as follows:

While the *Manitoba Securities* case differs with respect to the form of the proceedings, it is a precedent with regard to the legal problem arising in the HFC case in that it defines the requirements to establish a trust. At p. 260 *O'Sullivan J.* stated:

It may be that there are some few persons who may be able to establish some trust such as a trust arising out of the collection of money in those rare cases where an investor took an assignment of a mortgage and appointed the company as their agent to collect, but there would be in any event formidable difficulties in the way of tracing such trust money.

These words apply even more strongly to the present case where no investor, even Mr. Harnden, can establish that their funds were the specific funds used to advance under a specific security. In every case money was removed from the trust account between the time that their cheque was deposited and the document indicating the trust was created ... Once the trust fund and trust investments have been improperly dealt with and monies improperly taken each of the investors is in the position of being unable to trace their specific funds and therefore the trust with regard to that specific amount attributable to each investor has been mixed and cannot be traced. HFC cannot reinstate the trust relationship in favour of some investors against other investors by then registering assignments in favour of some investors in trust and designating some securities on the books of HFC as belonging to certain investors.

¶ 33 With the greatest of respect to Rosenberg J., it is my view that his reasoning is flawed (although the result reached by him is probably the right decision for the vast majority of Holden Financial's investors). Tracing of funds is not a requirement to establish a trust. Trusts are commonly created with no payment of funds from the beneficiary to the trustee. Tracing is not an ingredient of a trust but, rather, it is an equitable remedy available in respect of trust assets.

¶ 34 As an example, suppose that A gives money to B for the purpose of acquiring an asset which B is to hold for A and that B uses the money for some other purpose and absconds. A will have to rely on the remedy of tracing if he or she wants to recover their funds or some other asset acquired with the funds. By contrast, suppose that A gives money to B for the purpose of acquiring an asset which B is to hold for A and that B does acquire that asset and holds it for A (whether using A's funds or otherwise). A is entitled to the asset because it is held in trust by B for A, and A does not need to rely of the doctrine of tracing to establish entitlement to the asset. The latter is what occurred in Eron, with the asset being an interest in a mortgage.

¶ 35 In stating that tracing is a requirement for the establishment of a trust, Rosenberg J. relied on comments made by O'Sullivan J.A. in *Re Manitoba Securities Commission v. Winnipeg Mortgage Exchange Ltd.* [See Note 7 below] That was the first decision of the Manitoba Court of Appeal dealing with Winnipeg Mortgage ("Winnipeg Mortgage No. 1"). The decision to which I referred in paragraph 3 of these Reasons for Judgment in connection with Eron Investment Corporation was the second decision of the Manitoba Court of Appeal dealing with Winnipeg Mortgage ("Winnipeg Mortgage No. 2").

Note 7: *Re Manitoba Securities Commission v. Winnipeg Mortgage Exchange Ltd.* (1980), 113 D.L.R. (3d) 257 (Man. C.A.).

¶ 36 I believe that Rosenberg J. misunderstood the comments of O'Sullivan J.A. in Winnipeg Mortgage No. 1. O'Sullivan J.A. did not think that the documents created a trust in respect of the mortgages because they made reference to the creation of mortgages of mortgages, which is not consistent with the creation of trusts in respect of the mortgages themselves (which is essentially what Huband J.A. concluded in Winnipeg Mortgage No. 2 for all but a few of the trust documents). In making the comments quoted by Rosenberg J., O'Sullivan J.A. was referring to a form of trust other than one created by the documentation and he was giving as an example a trust arising out of the collection of money by Winnipeg Mortgage which the investor would have to trace in order to successfully claim.

¶ 37 Ironically, the argument which Rosenberg J. accepted in Holden Financial (based on the comments of O'Sullivan J.A. in Winnipeg Mortgage No. 1) was expressly rejected by Huband J.A. in Winnipeg Mortgage No. 2:

The lack of identification of the moneys paid in by a customer with a particular mortgage acquired by W.M.E. does not affect the validity of the trust. The question of identifying or tracing trust property arises only after the declaration of trust has been made. It matters not that the customer's money has become "lost" prior to the declaration being made. Up to the time the declaration is made the customer is simply a creditor of W.M.E. But W.M.E. has assets, and in recognition of its financial obligation to the customer, W.M.E. is entitled to declare that it holds some part of its assets as trustee for the customer, from whom W.M.E. had received funds. (p. 144)

¶ 38 I agree with the submission of Mr. Fredricksen that when a trustee has been given monies to acquire an asset and the trustee appropriates or ear marks such an asset for the beneficiary, the beneficiary will have a trust interest in the asset without the necessity of tracing his or her money to the asset. In addition to the above comments of Huband J.A., this proposition is demonstrated in cases involving insolvent stock brokers: see, for example, *Re Stobie-Forlong-Matthews, Limited* [See Note 8 below] and *Re Waite, Reid & Co. Ltd.* [See Note 9 below]

Note 8: *Re Stobie-Forlong-Matthew, Limited*, [1931] 1 W.W.R. (Man. C.A.).

Note 9: *Re Waite, Reid & Co. Ltd.* (1969), 5 D.L.R. (3d) 229 (Ont. S.C.).

¶ 39 In the *Waite, Reid* decision, while the Court held that the customers were entitled to securities appropriated to them, the Court did order a pro rata division of the securities which had not been appropriated to customers. A similar example is the case of *Barlow Clowes International Ltd. (in liquidation) v. Vaughan*. [See Note 10 below] In that case, the Court held that shares acquired with investors' monies were intended to form a common fund and were not to be allocated to individual investors. The Court held that the application of the rule in *Clayton's Case* [See Note 11 below] (i.e., first in, first out) would be impractical and would result in injustice between the investors, with the result that the assets were ordered to be shared by the investors *pari passu* in proportion to the amounts owed to them. This resembles the initial

situation in Eron Investment Corporation where the investors gave the money to Eron Investment Corporation with the intention that all investor funds would be pooled and invested in numerous Eron mortgages without allocation among the investors. However, it is distinguishable from the situation in Eron Mortgage Corporation where it was the intention at all times that the mortgages (or interests therein) would be appropriated to the investors in accordance with their agreements with Eron.

Note 10: Barlow Clowes International Ltd. (in liquidation) v. Vaughan, [1992] 4 All ER 22 (Eng. C.A.).

Note 11: Clayton's Case, Devaynes v. Noble, [1814-23] All ER Rep. 1.

¶ 40 In Re Urman, [See Note 12 below] a trust between a mortgage broker and multiple investors was upheld without requiring the investors to trace their funds. The Court did not specifically deal with the issue of tracing but, in holding that there had been a sufficient appropriation, it relied on the decision in Taylor v. London & County Banking Co. [See Note 13 below] In that latter case, a solicitor had misappropriated trust money and on his trust ledger he made a note that a mortgage which he held in his own right was to cover the amount he had defrauded from the trust. This notation was held to be a sufficient appropriation of the mortgage to create a trust in favour of the defrauded trust estate. The defrauded trust estate was obviously unable to trace its trust funds into the mortgage because the funds were not used by the solicitor to acquire the mortgage.

Note 12: Re Urman (1983), 44 O.R. (2d) 248 (Ont. C.A.).

Note 13: Taylor v. London & County Banking Co; London & County Banking Co. v. Nixon, [1901] 2 Ch. 231.

¶ 41 In addition to Winnipeg Mortgage No. 2 and the other decisions which I have discussed above, the authorities relied upon by Mr. Hobbs in support of his position for pooling were (i) Re Ontario Securities Commission and Greymac Credit Corp., [See Note 14 below] (ii) Chering Metals Club Inc. (Trustee of) v. Non-Discretionary Cash Account Trust Claimants, [See Note 15 below] (iii) Ontario (Securities Commission) v. Consortium Construction Inc., [See Note 16 below] (iv) Re Major Trust Co., [See Note 17 below] (v) Re Winsor and Bajaj [See Note 18 below] and (vi) Re Can Corp. Financial Services Ltd. [See Note 19 below] Other than Can Corp. Financial (and Winnipeg Mortgage No. 2), I do not find these authorities to be of assistance because they involve situations where the trust corpus was mixed and had not been allocated to beneficiaries.

Note 14: Re Ontario Securities Commission and Greymac Credit Corp. (1986) 55 O.R. (2d) 673 (Ont. C.A.).

Note 15: Chering Metals Club Inc. (Trustee of) v. Non-Discretionary Cash Account Trust Claimants (1991), 7 C.B.R. (3d) 105 (Ont. Gen. Div.).

Note 16: Ontario (Securities Commission) v. Consortium Construction Inc., [1993] O.J. No. 1408 (Q.L.) (Ont. Gen. Div.).

Note 17: Re Major Trust Co. (1972), 33 D.L.R. (3d) 481 (P.E.I.S.C.).

Note 18: Re Winsor and Bajaj (1990), 75 D.L.R. (4th) 198 (Ont. Gen. Div.).

Note 19: Re Can Corp. Financial Services Ltd. (1991), 6 C.B.R. (3d) 216 (Ont. Gen. Div.).

¶ 42 In Greymac Credit, the contest was between four beneficiaries who had provided monies to the trustee which had mixed the funds and then dissipated part of them. The Court held that the rule in Clayton's Case (i.e., first in, first out) did not apply and that the funds should be distributed on a pro rata basis to the beneficiaries.

¶ 43 In Chering Metals, the trust corpus was bullion which had been purchased with monies provided by investors. The bullion was not appropriated among the investors and the Court directed that there be a pro rata distribution.

¶ 44 Consortium Construction Inc. was a decision by Rosenberg J., the judge in Holden Financial. The investors provided monies for the purchase of real estate projects. The Consortium Group did not account for revenues and expenses on a project-by-project basis, and funds were combined and commingled. Rosenberg J. approved a scheme of distribution proposed by the Receiver-Manager of the Consortium Group which provided that investors in certain projects would be paid pro rata from the realization of those projects and that the remaining investors would be treated as unsecured creditors. Rosenberg J. concluded that all of the investors' monies in respect of certain projects were deposited into separate bank accounts in two instances and, therefore, those investors collectively had a constructive trust with respect to those projects. The remaining investors could not establish a constructive trust and they were held to rank as unsecured creditors.

¶ 45 In Re Major Trust Co., a trust company accepted monies for the purchase of guaranteed investment certificates. These monies were mixed in a common fund with other monies of the trust company. The Court held that although the monies paid by the holders of the investment certificates were held in trust by the trust company, the holders of the certificates were not entitled to be paid from the mixed fund in preference to the other claimants because they could not trace their monies once they were mixed with the other funds.

¶ 46 Re Winsor and Bajaj involved a shortfall in a solicitor's mixed trust account. The Court ruled that the clients whose monies were deposited into the trust account should share in the remaining funds on a pro rata basis.

¶ 47 That brings me to Winnipeg Mortgage No. 2, the case which I followed in connection with Eron Investment Corporation, and Can Corp. Financial, which also followed Winnipeg Mortgage No. 2. As I mentioned above, Huband J.A. found that the documentation created valid trusts of the mortgages (except where they made reference to the creation of mortgages of mortgages) but the majority choose to disregard the trusts on the basis that the allocation of the mortgages had been done arbitrarily. The investors had put their faith in Winnipeg Mortgage and they had no input as to the mortgages allocated to them by the trust agreements.

¶ 48 The reasoning of Freedman C.J.M., speaking for the majority, was thus:

In light of the facts emerging from that extract [i.e., that the investors had no control over the mortgages allocated to them], it would be grossly unfair to give a

preferred position to those who happened to have been allocated "good" mortgages, and a subordinate position to those who were allocated "bad" mortgages. Our disposition of the controversy should reflect two things - (1) the intention of the parties when the transactions were entered into, and (2) the necessity for fairness in the ultimate result. Concerning the first, it cannot be doubted that if, on the day before the bubble burst, the investors had been asked whether each of them stood on the same level as the others, the answer would assuredly have been in the affirmative. An answer suggesting that the investors stood on different levels would have been inconsistent with the intention both of the investors and of the companies. As for the second, to make preferred creditors out of those who by sheer luck received "good" mortgages would be to make ourselves slaves to contingency and to deny ourselves the power to do justice in accordance with the maxim that equality is equity. I would treat all the investors equally by pooling the available assets and dividing them among the investors according to their respective claims as proved. (p. 123)

¶ 49 I followed this reasoning in relation to Eron Investment Corporation. The investors gave their money to Eron Investment Corporation with the knowledge that their funds would be mixed with the money received from other investors and that the mixed funds would be invested in Eron mortgages at the discretion of Eron Investment Corporation. There was no allocation of investors to particular mortgages and no trust declarations were completed. When the governmental regulators raised questions and legal advice was obtained, Eron Investment Corporation unilaterally allocated its interests in Eron mortgages to most of the investors, while giving some of the investors a choice between various mortgages. There were other defects in the allocation process. I ruled that the initial pooled character of the investment should prevail over the flawed allocation of the mortgage interests.

¶ 50 This approach was also followed in Can Corp. Financial, which was not cited to me when I made my decision in connection with Eron Investment Corporation. That case involved a mortgage broker which used investors' monies to make mortgages. The mortgage broker provided the investors with documents entitled "Declarations of Trust" and "Mortgage Participation Agreements". However, the mortgage broker was authorized to transfer an investor's participation from one mortgage to another with no consultation. Chadwick J. concluded that the above quoted comments of Freedman C.J.M. in Winnipeg Mortgage No. 2 had equal application to the case before him and he ordered that the assets of the mortgage broker be distributed by way of a pooling arrangement.

¶ 51 Should I likewise utilize this approach in the present situation and order a pro rata distribution despite the existence of the trust declarations? The answer to this question, in my view, is found in the second paragraph of Freedman C.J.M.'s reasons in Winnipeg Mortgage No. 2:

Central to an understanding of this case is the recognition that the investors became such under circumstances that were markedly different from the usual case of this kind. Ordinarily, a person wishing to invest his money in a mortgage will be concerned with the nature of the mortgage - What property is it on? What is the value of that property? Is there a sufficient margin between the amount of the proposed mortgage and the total value of the property? Is the personal

covenant of the mortgagor reliable as an added protection in the event that things go sour and resort to that covenant becomes necessary? These are the kinds of questions which will engage the attention of a prospective investor in the ordinary case. But not so here; and that is what makes this case unique, that is why it must be uniquely treated. (p. 120)

While the typical Eron investment may not represent the ordinary case in view of the syndicated nature of the loans, it is the ordinary case in the sense that the investor made a risk assessment at some level and made a conscious decision to invest his or her money in a particular mortgage (which was subsequently appropriated to the investor by way of the trust declaration). Mr. Fredricksen made the distinction between obtaining an interest in a mortgage by choice or by chance, and I agree with this distinction.

¶ 52 The Eron investors choose to invest in the mortgages allocated to them by way of the trust declarations and there is no equitable reason to deprive them of their choices. There are "good" mortgages and "bad" mortgages but the investors were the ones who made the choices to invest in them. There is no reason why they should not enjoy the benefits or bear the adverse consequences of their decisions. The intention of the parties when they entered into the transactions was that the investors would have an interest in the mortgage loan which they selected and that all investors would not stand on the same footing. In this case, equality among the investors would constitute an inequity because it would represent a variation of the contracts and trust arrangements between Eron (or its numbered companies) and the investors without proper justification at law or in equity. Accordingly, the reasoning in Winnipeg Mortgage No. 2 does not apply to the present situation.

¶ 53 The last authority to which I will refer is Yorkshire Trust Company v. Empire Acceptance Corporation Limited, [See Note 20 below] another decision which was not cited to me when I made my decision in relation to Eron Investment Corporation. In that case, this Court held that there was no triable issue with respect to a pooling of investors who were allocated to mortgages by the mortgage broker as a matter of chance. Although this case supports my conclusion, I choose not to rely on it because its reasoning is not reconcilable with Winnipeg Mortgage No. 2, which I consider to be a more fully reasoned and authoritative decision.

Note 20: Yorkshire Trust Company v. Empire Acceptance Corporation Limited (1978), 28 C.B.R.(N.S.) 225 (B.C.S.C.).

CONCLUSION

¶ 54 The Judicial Trustees are directed to distribute the monies recovered on each mortgage in accordance with the trust declarations relating to the mortgage irrespective of the account into which the investors' funds were deposited. An incoming investor who directly paid out an outgoing investor will be in the same position as was the outgoing investor. The Judicial Trustees are at liberty to apply for further directions if there is no trust declaration for a mortgage (or other security) or if there are issues relating to the identity of the beneficiaries under the trusts. The Judicial Trustees are also at liberty to apply for directions with respect to any of the

remaining 34 questions posed in the report of the principal Judicial Trustee which have not been answered or rendered moot by these Reasons for Judgment.

TYSOE J.

QL Update: 990223
cp/d/lmt/DRS