Court File No. CV-19-629552-00CL

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

AND IN THE MATTER OF A PLAN OF ARRANGEMENT OF DEL EQUIPMENT INC.

Applicant

FACTUM OF THE APPLICANT

(returnable May 5, 2020)

April 29, 2020

Goodmans LLP
Barristers & Solicitors
Bay Adelaide Centre
333 Bay Street, Suite 3400
Toronto, ON M5H 2S7

Jason Wadden LSO #: 46757M
Christopher Armstrong LSO#: 55148B
Andrew Harmes LSO#: 73221A

Tel: 416.979.2211
Fax: 416.979.1234

Lawyers for the Applicant,
Del Equipment Inc.

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I. OVERVIEW

1. DEL Equipment Inc. ("**DEL**" or the "**Company**") brings this motion for an Order requiring GCI Industries Inc. ("**GCI**", and with its affiliates, "**Gin-Cor**") to return $874,107.08 (the "**Funds**") to DEL that Gin-Cor's counsel is currently holding in trust pursuant to the Order granted, on consent, by the Honourable Justice Hainey on November 5, 2019.

2. DEL filed for protection under the *Companies' Creditors Arrangement Act* (the "**CCAA**") on October 22, 2019, following numerous efforts to turn its business around. Those efforts included entering into the Management Agreement (defined below) with GCI, which operated in the same industry, pursuant to which GCI and its top executives took over management of DEL in 2017 and GCI and its executives became fiduciaries of DEL. The Management Agreement was terminated in late July 2019. As a result, as of July 2019, GCI was fully aware of DEL's financial position, including its accounts receivable, its expected receipts over the August – September 2019 time period, and its secured creditors and priority payables. At that time, GCI believed DEL was a failing business and would be insolvent unless drastic measures were immediately taken.

3. At the time the Management Agreement was terminated in July 2019, DEL was owed $874,107.08 – i.e., the Funds – from Mack Defense, LLC ("**Mack Defense**") on account of purchase orders placed the previous year, in April and November 2018. Those purchase orders were made, and the products were manufactured, while GCI was running DEL.

4. Mack Defense paid the Funds in two installments on August and September 2019. However, Mack Defense mistakenly paid the Funds to GCI, not DEL. Despite being concerned about the legitimacy of the payment, GCI refused to give the Funds to DEL or

return them to Mack Defense. Rather, GCI tried to pass off the payment as having come from, or having been assigned to it, by DEL. It then refused to turn the Funds over to DEL on the basis that DEL owes Gin-Cor (and not just GCI) for outstanding trade payables that are subject to the CCAA stay.

5. There is no dispute that GCI was not the intended recipient of the Funds. It is clear that GCI has unjustly enriched itself and has attempted to give itself a preference over DEL's other creditors. Moreover, GCI has violated its ongoing fiduciary obligations to DEL by keeping DEL's money it had no right to receive in the first place – it could not have taken that money itself out of DEL's bank account and it cannot keep the Funds because a third party, Mack Defense, made a mistake.

6. Compounding the inequities of GCI's actions is the fact that it appears that Mack Defense's error in sending the Funds to GCI was caused by a mistake or misunderstanding by one of GCI's own employees in April 2020, while GCI was still running DEL.

7. For these reasons, DEL respectfully submits that the Funds must be ordered to be delivered to DEL and that they are subject to a constructive trust in DEL's favour in the meantime.

II. FACTS

A. DEL and the GCI Transaction

8. Prior to the CCAA proceedings, DEL was a leading Canadian truck body and equipment "up-fitter" that engineered, designed, manufactured and sold special truck bodies, attachments, equipment and work-ready vehicles nationwide through its six manufacturing and distribution locations.

Affidavit of Douglas Lucky, sworn October 20, 2019 (the "**Lucky Affidavit**"), para. 4; Motion Record of DEL Equipment Inc. dated April 29, 2020 ("**MR**"), Tab 2, p. 12.

9. In June 2017, DEL and GCI entered into an agreement (the "**Management Agreement**") pursuant to which GCI would acquire a 40% equity interest in DEL and would assume management control of DEL for a nominal sum, with a view to earning a 100% equity interest upon the achievement of certain profitability-related milestones (the "**GCI Transaction**").

Lucky Affidavit, para. 7; MR, Tab 2, p. 13.

10. Unfortunately, the GCI Transaction did not produce the hoped-for synergies, with the result that DEL suffered increasing losses between 2017 and 2019. In July 2019, the GCI Transaction was terminated on or about July 18, 2019, and GCI ceased to manage DEL's business as of that date.

Lucky Affidavit, para. 9; MR, Tab 2, p. 13.

B. Sales to Mack Defense

11. In July and November 2018, DEL received purchase orders ("**POs**") from Mack Defense for certain trucks (the "**MD Trucks**") to be delivered to the Canadian Department of National Defense ("**DND**") and the Parks Canada Agency ("**Parks Canada**").

Lucky Affidavit, para. 61; MR, Tab 2, p. 31.

12. Over late 2018 and the first half of 2019, DEL carried out the work and delivered the MD Trucks to DND bases and Parks Canada locations between May 3, 2019, and June 25, 2019.

Lucky Affidavit, para. 61; MR, Tab 2, p. 31.

13. On or about June 6, 2019, DEL issued a series of invoices to Mack Defense for the MD Trucks totaling $874,107.08, which invoices were due and payable upon receipt (the "**MD Invoices**"). Although the quotes and the MD Invoices delivered to Mack Defense include the logo and trade name "Gincor Werx" due to the co-branding contemplated by the Management Agreement, the MD Invoices stated that they were issued by DEL. The POs themselves were addressed to "Del Equipment Ltd".[1]

Lucky Affidavit, paras. 14 and 61; MR, Tab 2, pp. 15 and 31

C. Mack Defense Mistakenly Sent the Funds to GCI

14. In response to the MD Invoices, Mack Defense sent the Funds to GCI, not DEL, by the following two payments: (i) $62,402.33 on August 29, 2019; and (ii) $811,699.75 on September 5, 2019.

Affidavit of Renzo Silveri, sworn November 3, 2019 (the "**Silveri Affidavit**"), para 33; Responding and Cross-Motion Record of Gin-Cor Industries Inc. dated November 4, 2019 (the "**Responding MR**"), Tab 2, p. 15

15. When the second payment was received, the fact of the payment was brought to the attention of Renzo Silveri, the COO and co-leader of GCI. Silveri testified that the payment was brought to his attention because it appeared to be a problem (ordinary course payments would not be brought to is attention, only problematic situations).

Transcript from the cross-examination of Renzo Silveri held April 20, 2020 (the "**Silveri Transcript**"), pp. 11-12, Q. 32-35 and pp. 25-26, Q. 96-100; MR, Tab 5, pp. 271-272 and pp. 285-286.

[1] Del Equipment Ltd. was the corporate entity that owned DEL's assets prior to an internal corporate reorganization undertaken in 2018.

16. Silveri was first advised that the Funds had been received while he was out of the office. He returned to the office on September 12, 2019, and looked into the payments because GCI was concerned about the legitimacy of the payments (particularly given that they had previously had problems with fraud and mistaken payments).

Silveri Transcript, pp. 26-27, Q. 98-103; MR, Tab 5, pp. 286-287.

17. After looking into the issue, Silveri determined that Mack Defense had mistakenly paid the Funds to GCI. While GCI had one outstanding invoice owing from Mack Defense, GCI has not put that invoice into evidence and Silveri did not know how much that invoice was for. Moreover, Silveri confirmed that Mack Defense has paid that invoice to GCI, so not only did GCI get paid what it was owed by Mack Defense, they have kept all the Funds that were meant for DEL.

Silveri Transcript, pp. 23-25, Q. 87-93; MR, Tab 5, pp. 283-285.

18. On September 13, 2019, Silveri emailed Doug Lucky, the Chief Restructuring Officer of DEL, writing:

> …As discussed between Paul M. and Luc approximately $1,000,000 is owing from Del to the GinCor Group on account of trade receivables. **Based on the funds received from Del** we will require an allocation for the specific invoices that you would like to have the deposit applied, alternatively we can discuss how a portion of the trade accounts can be secured by the GinCor Group for future payment by Del [emphasis added]

Silveri Affidavit, para. 44; Responding MR, Tab 2, p. 17.

19. On cross-examination, when faced with the fact that he tried to pass off the receipt of the Funds as having come from DEL, Silveri said that he assumed that DEL had "assigned" the amounts due from Mack Defense to GCI because of the amounts DEL owed to Gin-

Cor. Silveri, a chartered accountant and former partner at Grant Thornton who worked with distressed companies, would know that a company in DEL's position (in troubled financial circumstances, with secured debt) would not have simply and without any announcement "assigned" a receivable representing 20% of its monthly cash flow to GCI. Tellingly, Silveri never called DEL to ask whether such an "assignment" had been made. Instead, he tried to pass off the receipt of such Funds as "DEL funds" in his email.

> Silveri Transcript, pp. 7-8, Q. 15-17; pp. 27-28, Q. 104-107; and pp. 29-30, Q. 114; MR, Tab 5, pp. 267-268, pp. 287-288, and pp. 289-290.
>
> Lucky Affidavit, para. 60; MR, Tab 2, p. 30.

20. Lucky responded to Silveri's email on September 16, 2019, noting that at first he could not figure out what Silveri was referring to when he referenced a payment from DEL because they both knew DEL had not made any payments, and then Lucky realized that Silveri was referring to the Funds that Mack Defense mistakenly sent to GCI:

> I have been puzzling with Paul over your last email trying to figure out what the devil you are talking about in "par d" knowing that DEL had not made any recent payments to you. Then it hit us. You are talking about the $867k that DEL's customer Mack Defense sent to you by mistake.
>
> Lucky Affidavit, Exhibit E; MR, Tab 2E, p. 150.
>
> Silveri Affidavit, para. 46; Responding MR, Tab 2, p. 17.

21. GCI has admitted that the Funds were not owing to it from Mack Defense and that the Funds are "Del funds". Also, Mack Defense admitted in telephone conversations (i) between Isabel Marques, DEL's controller, and Stoddart, on September 12, 2019; and (ii) between Douglas Lucky and Brian Happel, Director of Business Control & Treasurer of Mack Defense, on September 19, 2019, that Mack Defense had inadvertently paid the

Funds to GCI; however, Mack Defense has refused to pay DEL the amount owed for the MD Trucks on the basis that it views the matter as a dispute between DEL and GCI.

Silveri Transcript, pp. 27-28, Q. 104-107; MR, Tab 5, pp. 287-288.

Lucky Affidavit, para. 62(e) and (i); MR, Tab 2, pp. 33-34.

Lucky Affidavit, Exhibit E; MR, Tab 2E, p. 149.

22. Notwithstanding these acknowledgements, GCI has taken the position that it is entitled to retain the Funds it wrongfully received from Mack Defense in order to set-off the Funds against obligations of DEL to GCI (and potentially to other Gin-Cor entities), or to unilaterally retain the Funds to secure any amounts owing by DEL to GCI.

23. Notwithstanding various demands by DEL to GCI to pay the Funds to DEL, GCI refused.

Lucky Affidavit, at para. 63, MR, Tab 2, p. 34.

24. Mack Defense had asked GCI to return the Funds, but GCI refused. Silveri testified that in his conversations with Mack Defense it has expressed the hope that DEL and GCI can work out the issue between themselves.

Silveri Transcript, p. 32-33, Q. 122; MR, Tab 5, pp. 292-293.

D. Root of the Mistake – Information Provided by Gin-Cor Employee to Mack Defense

25. On September 10, 2019, just before the email exchanges between Silveri and Lucky discussed above, DEL had started to follow up with Mack Defense regarding payment for the MD Invoices. As a result of those inquiries, DEL learned that the Funds had been sent to GCI, and not DEL. Based on its investigation, DEL determined the following:

(a) On April 10, 2019, Brett Stoddart, a buyer at Mack Defense, emailed Jim Hazlehurst, a DEL employee, asking for payment instructions for the MD Trucks. When Hazlehurst did not immediately respond, Stoddart emailed a GCI employee minutes later asking her for the payment instructions.

Lucky Affidavit, para. 62(a); MR, Tab 2, p. 32.

Lucky Affidavit, Exhibit C; MR, Tab 2C, p. 137.

(b) The GCI employee responded by providing Mack Defense with GCI's own payment instructions, not DEL's payment instructions (this was at the time GCI was still managing DEL). From the email evidence, it appears that the GCI employee misunderstood Mack Defense's request, and gave Mack Defense the payment instructions for GCI because there was one invoice (#53998) owing by Mack Defense to GCI.

Lucky Affidavit, para. 62(b); MR, Tab 2, p. 32.

Lucky Affidavit, Exhibit C; MR, Tab 2C, pp. 135 and 139.

(c) About an hour after Stoddart's email, Steve Lewin, a DEL employee emailed Stoddart and advised that DEL was "…now Del Equipment Inc. operated as Gincor Werx" and provided correct payment instructions for DEL, and filled out a form with DEL's information and correct banking information.

Lucky Affidavit, para. 62(c); MR, Tab 2, p. 33.

Lucky Affidavit, Exhibit D; MR, Tab 2D, p. 141.

(d) Mack Defense used the incorrect information provided by the GCI employee when processing the MD Invoices and transferring the Funds.

Lucky Affidavit, para. 62(d); MR, Tab 2, p. 33.

26. Although GCI did do some sub-contracting work for DEL in relation to up-fitting the MD Trucks, that sub-contracting relationship was between DEL and GCI, not between GCI and Mack Defense. Moreover, DEL has paid GCI for the vast majority of this sub-contracting work, with only $8,717.96 outstanding and subject to the CCAA stay. As such, except for this very small amount, there is no relationship whatsoever between the amounts DEL owes to Gin-Cor and the MD Trucks or the Funds.

Supplementary Affidavit of Douglas Lucky, sworn January 15, 2020 (the "**Supplementary Lucky Affidavit**"), at para. 14; MR, Tab 3, p. 215.

III. ISSUE

27. The sole issue on this motion is that GCI has improperly received and retained the Funds and that they must be delivered to DEL.

IV. LAW & ARGUMENT

A. Preliminary Matter – Whether the Funds Are A Specific Fund Is Not Relevant

28. The issues arising in this motion were set out in the Litigation Protocol approved by the Order of Justice Hainey dated February 27, 2020 (the "**Litigation Protocol**"). Based on the negotiations of the parties, the two "issues" in the Litigation Protocol were defined as the "Fund Dispute" and the "Set-off Dispute", with the parties reserving all rights with respect to the positions that they may take.

29. The "Fund Dispute", raised by GCI, questions whether the Funds are a "specific fund". That issue of whether or not funds are a "specific fund" is only part of the test under Rule 42.05, which deals with the interim recovery of funds. At the time of the initial CCAA

application, DEL brought a motion under Rule 42.05 to have the Funds paid into Court. On the come back hearing for the Rule 42.05 motion, the motion was resolved and this Court granted an order, on consent, that the Funds were to be paid into GCI counsel's trust account (the "**Second Preservation Order**"). That order was on consent, and was not appealed or set aside.

30. Accordingly, whether the Funds are a "specific fund" is no longer in issue. It is not a relevant consideration in determining whether such amounts are to be paid to DEL or if they are impressed with a constructive trust. The Funds continue to be held, in trust, by GCI's counsel.

31. Any argument by GCI at this stage that the Funds do not constitute a "specific fund" is therefore an impermissible collateral attack on the Second Preservation Order, and cannot be considered.

> *Wilson v. R.* (1983), 4 DLR (4th) 577 at para. 8; Book of Authorities ("**BOA**"), Tab 1.
>
> *R. v. Litchfield*, [1993] 4 SCR 333 at paras. 19-20; BOA, Tab 2.
>
> *Hunter v. Chief Constable of West Midlands*, [1981] UKHL 13, p. 6; BOA, Tab 3.

B. GCI Has Been Unjustly Enriched

32. GCI has been unjustly enriched as a result of receiving the Funds. The unjust enrichment test is well-known and met in this case:

(a) GCI received an incontrovertible benefit by receiving the Funds;

(b) DEL suffered a deprivation because the Funds were owed to it and were intended to be delivered to it; and

(c) There is no juristic reason for GCI's receipt of the Funds from Mack Defense.

Kerr v. Baranow, 2011 SCC 10 at para. 32; BOA, Tab 5.

33. The first two factors are satisfied. GCI has received an incontrovertible benefit in the form of the Funds (i.e., money), and DEL has suffered a corresponding loss by not receiving the Funds.

34. There is also no juristic reason for GCI's enrichment of receiving and keeping the Funds.

35. First, the Funds were never intended for GCI: (i) the Funds were intended to be paid to DEL on account of the MD Invoices; (ii) GCI provided the incorrect account information to Mack Defense which caused the Funds to be improperly diverted to and retained by GCI; and (iii) GCI is keeping the Funds not on the basis that the manner in which it came into the Funds was proper or justified by a contract other legal obligation, but on the basis of other factors that are extraneous to the mistaken transfer of the Funds to it. There is no juristic reason justifying GCI receiving and retaining the Funds from Mack Defense – it had no right at law or equity to receive the Funds. What it has effectively done is to have effected a garnishment for which (i) it has no judgment; (ii) it has no writ of garnishment; and (iii) which garnishment would result in a preference over other unsecured creditors were GCI entitled to the Funds.

See *Cotton Ginny Inc.*, July 16, 2008, Court File No. 08-CL-7415 decision by Justice Morawetz at paras. 44-51, in which Justice Morawetz held that even a properly effected garnishment pre-filing cannot be held by the sheriff in the face of a CCAA stay and must be returned to the Debtor; BOA, Tab 4.

36. Second, GCI cannot rely on "set-off" as a "juristic reason" for its enrichment.

37. Set-off is a defence to a claim and is not a juristic reason within the unjust enrichment test. The Supreme Court of Canada in *Kerr* held that set-off is not a "juristic reason", and stated that the phrase "juristic reason" is…

> intended to reveal whether there is a reason for the defendant to retain the enrichment, not to determine its value or whether the enrichment should be set off against reciprocal benefits.
>
> *Kerr v. Baranow*, 2011 SCC 10 at para. 114; BOA, Tab 5, citing *Wilson v. Fotsch*, 2010 BCCA 226 at para. 30; BOA, Tab 6.

38. Set-off, which is a defence, is used to determine the net amount owed at the quantum or damages stage of a proceeding, which determination occurs after the determination of the parties' legal rights. The Supreme Court of Canada in *Kerr* adopted the following holding of the British Columbia Court of Appeal in *Wilson v. Fotsch* on whether set-off qualifies as a "juristic reason":

> The juristic reason analysis is intended to establish whether there is a reason for the defendant to retain a proven enrichment, not to determine its value or off-set reciprocal enrichment by the plaintiff. The issues of quantum and set-off are for the quantification of the award following a finding of unjust enrichment. By interposing the issue of extent into the juristic reason stage, the full unjust enrichment analysis is short-circuited…" [emphasis added]
>
> *Wilson v. Fotsch*, 2010 BCCA 226 at paras. 28 and 30; BOA, Tab 6.

39. Set-off is therefore not a juristic reason for which GCI can rely upon for the second part of the unjust enrichment test.

40. Third, as noted above, GCI has acknowledged that it received the Funds by mistake, and hence there is no juristic reason for the enrichment.

Silveri Affidavit, para. 39; Responding MR, Tab 2, p. 16.

Silveri Transcript, p. 27-28, Q. 103-107; MR, Tab 5, pp. 287-288.

Kerr v. Baranow, 2011 SCC 10 at paras. 31-32; BOA, Tab 5.

41. Fourth, even if the GCI employee who provided the incorrect information to Mack Defense did so by an innocent mistake, the innocent mistake does not turn GCI, as it argues, into an "innocent" recipient of the Funds, thus giving it a juristic reason for the enrichment. This is particularly the case given that GCI was a fiduciary to DEL and cannot take advantage of its own or others mistakes to DEL's detriment.

42. Fifth, the result of GCI keeping the Funds is that it has received an improper preference over DEL's other creditors. As noted, GCI and its senior managers were in the position of a fiduciary to DEL. They were aware of DEL's secured and priority creditors, and other unsecured creditors. In fact, Silveri testified in both his affidavit and on cross-examination that GCI was increasingly worried that they were not going to be paid. It was with that knowledge that they decided to keep the misdirected Funds. Keeping funds that are not yours because you are concerned about being paid does not create a juristic reason for an unintended enrichment. GCI could not have reached its hand into DEL's bank account and taken the money out of concern of not being paid, and the fact that Mack Defense used the wrong bank account information (caused by Gin-Cor) does not justify or create a juristic reason for GCI keeping the Funds that were intended to be transferred to DEL's bank account.

43. Lastly, there is a fallacy to GCI's argument that it can keep the Funds. This is because GCI suggests that DEL should seek redress from Mack Defense. However, if Mack Defense paid DEL for the MD Invoices, GCI would not have any right to retain the Funds as against

Mack Defense. GCI does not gain a 'juristic reason' for keeping the Funds because DEL, and not Mack Defense, brought this motion.

44. As a result, the test for unjust enrichment set out by the Supreme Court in *Kerr* is satisfied and GCI has been unjustly enriched and, as explained below, the Funds are subject to a constructive trust.

C. DEL is Entitled to Restitution for Mistaken Payments

45. DEL is also entitled to the return of the Funds based on relief of mistaken payments, and specifically "the law of restitution, the central principle of which is the reversal of unjust enrichment."

> *Pinnacle Bank, N.A. v. 1317414 Ontario Inc.*, 2002 CarswellOnt 218 (ONCA) at para. 17, citing Halsbury's Laws of England, 4th Edition re-issue, Mistake para. 69 (Butterworths; London 1999); BOA, Tab 7.

46. It is well settled that funds paid under mistake of fact may be recovered on the basis that the recipient would otherwise be unjustly enriched, and that a party will be unjustly enriched where it has received a benefit due to a mistake of fact. GCI's unjust enrichment resulted from a mistake of fact, and DEL is entitled to restitution as a result.

> *Pinnacle Bank, N.A. v. 1317414 Ontario Inc.*, 2002 CarswellOnt 218 (ONCA) at para. 17, citing Halsbury's Laws of England, 4th Edition re-issue, Mistake para. 69 (Butterworths; London 1999); BOA, Tab 7.
>
> *Royal Bank v. R.*, 1931 CarswellMan 20 (Man KB); BOA, Tab 8.

47. The Ontario Court of Appeal in *Pinnacle Bank, N.A. v. 1317414 Ontario Inc.*, set out the test for recovery of funds paid under mistake of fact:

(a) First, the mistake must have been honest on the part of the person paying the funds. It is not disputed that Mack Defense made an honest mistake in paying the Funds to GCI, believing either that it was paying the Funds to DEL or that GCI and DEL were the same entity;

(b) Second, the recipient of the funds must "in some way be a party to the mistake, either as inducing it, responsible for it, or connected with it". GCI is a party to the mistake as a result of its employee wrongfully (even if innocently) providing Mack Defense with instructions and banking information to wire transfer the Funds into GCI's own account, thereby inducing the mistaken transfer;

(c) Third, there must be an obligation to make the payment. It is not disputed that Mack Defense had an obligation to pay the Funds to DEL pursuant to the MD Invoices; and

(d) Fourth, the recipient of the funds must have no legal, equitable, or moral right to retain the money as against the payer. As discussed above, GCI has no right to receive the monies from Mack Defense (the payer) – GCI has admit that it has been paid in full by Mack Defence and, accordingly, has not right to keep the Funds as against Mack Defence.

Pinnacle Bank, N.A. v. 1317414 Ontario Inc., 2002 CarswellOnt 218 (ONCA) at para. 10; BOA, Tab 7.

48. As a result, the test for mistake of fact is satisfied in the circumstances, resulting in unjust enrichment, and DEL is entitled to restitution in order to reverse the unjust enrichment.

D. The Appropriate Remedy for the Unjust Enrichment and Breach of Fiduciary Duty Is A Constructive Trust Over the Funds

49. The Supreme Court of Canada held in *Soulos v. Korkontzilas* that where there is unjust enrichment a constructive trust is the natural remedy to effect restitution:

> I conclude that in Canada, under the broad umbrella of good conscience, constructive trusts are recognized both for wrongful acts like fraud and breach of duty of loyalty, as well as to remedy unjust enrichment and corresponding deprivation. While cases often involve both a wrongful act and unjust enrichment, constructive trusts may be imposed on either ground: where there is a wrongful act but no unjust enrichment and corresponding deprivation; or where there is an unconscionable unjust enrichment in the absence of a wrongful act.

Soulos v. Korkontzilas, 1997 CarswellOnt 1489 (SCC) at para. 43; BOA, Tab 9.

Moore v. Sweet, 2018 SCC 52 at paras. 32-33; BOA. Tab 10.

50. Moreover, a constructive trust is appropriate where there has been a breach of fiduciary duties. GCI and its senior executives, including Silveri, owed ongoing fiduciary duties to DEL, including the residual duty of loyalty, which they breached by retaining Funds that they knew or came to know were to be paid to DEL on account of work that DEL performed, particularly given that they were the senior management team and fiduciaries of DEL at the time the work was performed.

Canadian Aero Service Ltd. v. O'Malley, [1974] SCR 592 (SCC) at para. 25; BOA, Tab 11.

Lac Minerals Ltd. v. International Corona Resources Ltd., [1989] 2 SCR 574 (SCC) at para. 132 (per Sopinka J., writing for the majority in regards to the fiduciary duty issue); BOA, Tab 12.

51. As a result of that breach of their fiduciary duties and the unjust enrichment, the appropriate remedy is that the Funds are subject to a constructive trust in DEL's favour.

Soulos v. Korkontzilas, 1997 CarswellOnt 1489 (SCC) at para. 43; BOA, Tab 9.

E. GCI Cannot Set-Off Against the Funds

52. DEL further submits that GCI cannot claim set-off even at the "damage quantification" stage because:

(a) the Funds are held (or will be held) subject to a constructive trust;

(b) GCI cannot rely on equitable set-off because it does not have clean hands due to its redirecting and interception of the Funds; and

(c) legal set-off does not apply.

53. Each of these points is discussed in greater detail below.

(i) The Funds Are Subject to a Constructive Trust and, As Trustee, GCI Cannot Exercise Set-off

54. Because the Fund are or will be protected by a constructive trust, GCI cannot set-off against the Funds. The Ontario Superior Court of Justice in *Commercial Union Life Assurance Co. of Canada v. John Ingle Insurance Group Inc.* concluded that it is impermissible for a trustee to set-off amounts against trust funds as it runs counter to the very notion of a trust:

> Although the foregoing cases have addressed the issue of set-off against a trust in different ways, they confirm that a trustee cannot justify withholding trust funds in breach of his or her trust obligations on the grounds that the beneficiary is indebted to him or her. Simply stated, a trustee cannot use the concept of set-off, legal or equitable, to justify self-help by breach of trust.

> *Commercial Union Life Assurance Co. of Canada v. John Ingle Insurance Group Inc.*, 2000 CarswellOnt 3155 (ONSC) at para. 334; BOA, Tab 13.

55. As a result of this constructive trust over the Funds, GCI is barred from effecting set-off against the Funds.

(ii) GCI Does Not Have Clean-Hands

56. GCI cannot avail itself of equitable set-off because it does not come before this Court with clean hands. The Ontario Superior Court of Justice in *Sherwood Dash Inc. v. Woodview Products Inc.* described the principle of the clean hands doctrine as follows:

> Judges of the courts of equity do not deny relief because a claimant is a villain or a wrongdoer; rather, the judges deny relief when the claimant's wrongdoing taints the appropriateness of the remedy being sought by the court.
>
> *Sherwood Dash Inc. v. Woodview Products Inc.*, 2005 CarswellOnt 7191 (ONSC) at paras. 51-52; BOA, Tab 14.

57. It was GCI's own actions in improperly directing Mack Defense to pay the Funds to it, rather than DEL, that has tainted the appropriateness of set-off in these circumstances (even if it was otherwise available, which is disputed). By redirecting and intercepting the Funds, GCI has caused the harm to DEL and the very circumstances that it is now asking this Court for relief against. Because the circumstances arose by GCI's own hands, it does not have clean hands and is not entitled to equitable set-off or other equitable relief.

(iii) Legal Set-off Does Not Apply

58. Further, GCI cannot avail itself of legal set-off because there is no mutuality between the debts being set-off. In this case, there is insufficient mutuality because there is no mutuality

of the "debts" between the parties, and there is no mutuality in the "right" in which they hold such amounts.

59. First, given that the Funds were transferred by Mack Defense to GCI, there is no mutuality between the parties in the transactions giving rise to the claims. This is made clear by the fact that Mack Defense also has a claim against GCI for mistaken payment because it too remains liable to DEL for its failure to pay the MD Invoices.

> *Green v. Mirtech International Security Inc.*, 2009 CarswellOnt 450 (ONSC) at para. 12; BOA, Tab 15.

60. In addition, as noted above, the Funds are or will be impressed with a constructive trust before any claim of set-off can be considered. As a result, the "right" in which GCI holds the Funds is that of trustee and not in its own right, but it only claims amounts owing from DEL in its personal right. As a result, there is no mutuality of "rights" in which the set-off claims are asserted. Therefore, legal set-off is not available to GCI.

F. GCI's Retention of the Funds Would Result in an Unlawful Preference, Contrary to the CCAA

61. Lastly, the redirection and interception of the Funds by GCI amounts to an unlawful preference that, if GCI were permitted to keep the Funds, would unlawfully benefit GCI to the detriment of DEL's other creditors. GCI knew of DEL's vulnerable financial position, as it admits it was becoming "increasingly concerned" about DEL's ability to make payment and Silveri admitted that he believed that DEL would be insolvent if drastic actions were not taken. GCI was also aware that it only had an unsecured claim and there were secured claims ahead of it. GCI was aware of DEL's financial position and would have known that if DEL did not receive the Funds, it would seriously and negatively impact

DEL's liquidity position. By retaining the Funds and not returning the mistaken payment or turning it over to DEL as the rightful and intended recipient, GCI in effect took for itself a substantial portion of DEL's cash ahead of DEL's secured creditors and in priority to other unsecured creditors, contrary to the parties' respective priority rankings.

Silveri Transcript, p.15-16, Q. 52-55; MR, Tab 5, pp. 275-276.

G. Additionally and in the Alternative, DEL Holds an Equitable Lien over the Property of GCI in the Amount of the Funds

62. An equitable lien is available in circumstances that would otherwise give rise to a constructive trust, including unjust enrichment, but where a constructive trust is not possible because the property has been comingled with other property to the point that it is not identifiable.

63. As stated by the Ontario Court of Justice, General Division in *Banton v. CIBC Trust Corp.* (affirmed by the Ontario Court of Appeal, leave to appeal to Supreme Court refused), an equitable lien can flow from the misappropriation of funds in a constructive trust:

> Where trust funds have been wrongfully mingled with funds of the trustees - or with funds of another person who, like Mr. Banton, must be considered to have had notice of the breach of trust - the persons seeking to recover the trust property - whether they be the beneficiaries or the trustees - have a right to a lien or charge against the commingled funds for the amount of the trust funds that were misapplied.

Banton v. CIBC Trust Corp., 1999 CarswellOnt 2596 (OCJ Gen Div) at para. 28, affirmed 2001 CarswellOnt 828 (ONCA), leave to appeal refused 2001 CarswellOnt 3069 (SCC); BOA, Tab 16.

64. As a result of GCI's unjust enrichment, as well as the constructive trust that exists or will likely exist in respect of the Funds as a result, DEL is entitled to an equitable lien over the property of GCI in the amount of the Funds.

H. In the Alternative, Only GCI has a Right to Set-Off Against the Funds

65. In the event the Court finds that GCI has a right to retain the Funds and set-off those funds against amounts owing by DEL (which is denied), it is only GCI, and not any other Gin-Cor entity, that has a right to set-off against the Funds. There is no basis upon which GCI can use those Funds to satisfy obligations owing by DEL to another Gin-Cor entity – this would be a type of inter-corporate group set-off that is not permissible as the other Gin-Cor entities were never in receipt of the Funds and have no right to retain any portion of them in satisfaction of any obligations owing to them by DEL. As stated in *The Law of Set-Off in Canada*:

> The basic rule is that a corporation will be treated as a separate legal entity for purposes of set-off and so will not have mutuality on debts owed by it to third parties with debts owed by third parties to its shareholders, directors or subsidiaries.
>
> Kelly R. Palmer, *The Law of Set-Off in Canada* (Aurora: Canada Law Book Inc., 1993), p. 244-245; BOA, Tab 17.

V. ORDER SOUGHT

66. For all of the above reasons, DEL respectfully requests an order in the form requested, with costs on a substantial indemnity basis.

ALL OF WHICH IS RESPECTFULLY SUBMITTED this 29th day of April, 2020

Goodmans LLP
Lawyers for the Applicant,
Del Equipment Inc.

SCHEDULE A
LIST OF AUTHORITIES

1. *Banton v. CIBC Trust Corp.*, 1999 CarswellOnt 2596 (OCJ Gen Div); affirmed 2001 CarswellOnt 828 (ONCA), leave to appeal refused 2001 CarswellOnt 3069 (SCC)

2. *Canadian Aero Service Ltd. v. O'Malley*, [1974] SCR 592 (SCC)

3. *Commercial Union Life Assurance Co. of Canada v. John Ingle Insurance Group Inc.*, 2000 CarswellOnt 3155 (ONSC)

4. *Cotton Ginny Inc.*, July 16, 2008, Court File No. 08-CL-7415 decision by Justice Morawetz

5. *Green v. Mirtech International Security Inc.*, 2009 CarswellOnt 450 (ONSC)

6. *Hunter v. Chief Constable of West Midlands*, [1981] UKHL 13

7. Kelly R. Palmer, *The Law of Set-Off in Canada* (Aurora: Canada Law Book Inc., 1993)

8. *Kerr v. Baranow*, 2011 SCC 10

9. *Lac Minerals Ltd. v. International Corona Resources Ltd.*, [1989] 2 SCR 574 (SCC)

10. *Moore v. Sweet*, 2018 SCC 52

11. *Pinnacle Bank, N.A. v. 1317414 Ontario Inc.*, 2002 CarswellOnt 218 (ONCA)

12. *R. v. Litchfield*, [1993] 4 SCR 333

13. *Royal Bank v. R.*, 1931 CarswellMan 20 (Man KB)

14. *Sherwood Dash Inc. v. Woodview Products Inc.*, 2005 CarswellOnt 7191 (ONSC)

15. *Soulos v. Korkontzilas*, 1997 CarswellOnt 1489 (SCC)

16. *Wilson v. Fotsch*, 2010 BCCA 226

17. *Wilson v. R.* (1983), 4 DLR (4th) 577 (SCC)

SCHEDULE B
TEXT OF STATUTES, REGULATIONS & BY-LAWS

N/A

IN THE MATTER OF THE *COMPANIES' CREDITORS ARRANGEMENT ACT*, R.S.C. 1985, c. C-36, AS AMENDED

Court File No. CV-19-629552-00CL

AND IN THE MATTER OF A PLAN OF ARRANGEMENT OF DEL EQUIPMENT INC.

Applicant

ONTARIO
SUPERIOR COURT OF JUSTICE
(COMMERCIAL LIST)

Proceeding commenced at Toronto

FACTUM OF THE APPLICANT
(returnable May 5, 2020)

Goodmans LLP
Barristers & Solicitors
Bay Adelaide Centre
333 Bay Street, Suite 3400
Toronto, ON M5H 2S7

Jason Wadden LSO #: 46757M
Christopher Armstrong LSO#: 55148B
Andrew Harmes LSO#: 73221A

Tel: 416.979.2211
Fax: 416.979.1234

Lawyers for the Applicant,
Del Equipment Inc.