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Ponzi scheme participants ordered to return payments that were "too good to be true"

By James R.G. Cook

James R.G. Cook
Partner
416.865.6628
jcook@grllp.com

Investors in a scheme that seems too good to be true should be aware that they may be liable to return the funds under principles of unjust enrichment or bankruptcy preference laws.

The claims in *Golden Oaks Enterprises Inc. v. Scott*, 2022 ONCA 509 (CanLII), arose from a Ponzi scheme in Ottawa that was advertised as a "rent-to-own" business (Golden Oaks) but was promoted by its principal owner (Lacasse) to certain individuals as a way to turn a quick profit by advancing funds for short time periods in exchange for high-interest promissory notes.

Over five hundred promissory notes were issued by Golden Oaks to investors from 2009-2013, with early investors earning commissions for persuading new investors to make loans. The interest on the issues increased to the point where it exceeded the criminal rate of 60%, and money from new investors was being used to pay existing investors.

The court later described the scheme as follows:

> Its core business was persuading investors to lend the company money with the lure of unrealistically high returns, to the profit of Lacasse and early investors. These returns were not being funded by the Rent2Own operations. These operations were not viable and generated almost no income. The interest and commissions paid to early investors in Golden Oaks were funded by money from later investors. Early investors and insiders did very well, assuming they withdrew their funds before the whole scheme collapsed in on itself in June 2013. Later investors and ordinary creditors who were totally unaware of the true nature of Golden Oaks' business were left holding the bag.

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After the scheme collapsed, Golden Oaks and Lacasse went into receivership and made assignments in bankruptcy.

A trustee in bankruptcy was appointed and brought several actions against individuals and companies who received payments from Golden Oaks in 2012 and 2013, which included commission payments and interest on promissory notes. The trustee's argument was that, as a Ponzi scheme, Golden Oaks was by definition insolvent, it never had enough money to pay what it owed to legitimate creditors, and the commission payments and usurious interest payments to the defendants deprived those creditors of their share of the company's remaining equity.

One of the defendants (LS), was a real estate agent who became involved with the company's operations in 2011 and signed a referral agreement for commissions in 2012. The trustee sought repayment of $72,575 paid to LS in *2012*-2013, on the basis that they were unlawful preferences under s. 95(1)(b) of the *Bankruptcy and Insolvency Act* (BIA). The payments consisted of commissions on referrals and payment on funds loaned by LS.

Under s. 95(1)(b) of the BIA, a payment made by an insolvent person in favour of a creditor who is not dealing at arm's length with the insolvent person, that has the effect of giving that creditor a preference over another creditor is void as against the trustee if it is made during the period beginning on the day that is 12 months before the date of the initial bankruptcy event and ending on the date of the bankruptcy.

The trial judge identified the indicia of a "non-arm's-length" transaction as the following: (1) a common mind directing the bargaining for both parties of a transaction; (2) parties to a transaction acting in concert without separate interests; and (3) *de facto* control: at paras 203-4, citing *Canada v. McLarty*, 2008 SCC 26, [2008] 2 S.C.R. 79, at para. 43, and *Montor Business Corporation v. Goldfinger*, 2016 ONCA 406, 36 C.B.R. (6th) 169, at para. 68.

The trial judge found that, since the payments were admitted by LS, the only question was whether the parties were dealing at arm's length. She found that they were not and that they were acting in concert under the direction of Lacasse to ensure the continued operation of the Ponzi scheme. As a result, the trial judge ordered LS to repay $72,575 in preferences to the estate of Golden Oaks.

On appeal, LS argued that while LS may have worked with Lacasse to further the Ponzi scheme through Golden Oaks, they were nonetheless at arm's length when it came to their own financial dealings involving both commission payments and loans.

The Court of Appeal noted that the trial judge had discounted the testimony of LS, finding that he was not truthful in his testimony. Although LS did not receive a salary from Golden Oaks, he was involved in the company's operations from mid to late 2012 and regularly represented the company or acted on its behalf. Further, the trial judge found that LS was both aware of the Ponzi scheme perpetrated by the company and acted expressly to further it, knowing that Golden Oaks was not deriving its revenue from its real estate holdings. One damaging email sent by LS in 2012 described the rent-to-own business as a "pyramid" and/or "Ponzie like", that could collapse like a house of cards.

The Court of Appeal agreed with the trial judge's conclusion that the relationship between LS and Golden Oaks could not be disentangled from their collaboration in furtherance of the Ponzi

scheme and they were therefore not acting at arm's length under s. 95(1)(b) of the BIA. With respect to the other investor appellants, the trustee sought to recover payments made by Golden Oaks on the basis that they were made to the deprivation of the company and the unjust enrichment of the defendants.

The trial judge found that the appellant investors knew or ought to have known that the returns promised on their investment were too good to be true and granted claims for repayment of interest. Essentially the trial judge imposed a "blue pencil" remedy, in which the appellants remained entitled to recover their principal (as ordinary creditors to the bankrupt company) but were required to repay all of the interest received through the Ponzi scheme.

On appeal, the investors' primary argument was that the claims for unjust enrichment were statute-barred by the *Limitations Act, 2002* since they were made by the trustee as successor in interest to Golden Oaks and the time limits for bringing the claims had expired by the time the trustee formally commenced the actions.

While the investments and interest payments giving rise to the Ponzi scheme took place well outside of the two-year limitation period under the *Limitations Act, 2002*, the trial judge found that the trustee's claims were not statute-barred as they were only discoverable once the trustee was installed, and it received legal authority to bring the actions.

The appellants argued that Golden Oaks must be imputed with Lacasse's knowledge of the fraud under the corporate attribution doctrine. However, the Court of Appeal reviewed the applicable corporate attribution principles in cases from *Dredge v. R.,* 1985 CanLII 32 (SCC) to *Ernst & Young Inc. v. Aquino*, 2022 ONCA 202, and concluded that the court's discretion should be exercised in this case so as *not* to attribute the knowledge of Lacasse to Golden Oaks.

In the Court of Appeal's view, attribution of Lacasse's knowledge to Golden Oaks (and its trustee) would lead to the perverse outcome of saving the appellants from the consequences of their collection of usurious interest, as well as depriving the trustee of a civil remedy that would inure solely for the collective benefit of legitimate creditors. Further, the social policy goal of promoting corporate responsibility to prevent fraud and regulatory non-compliance through the corporate attribution doctrine is not advanced where a sole fraudster is in charge of a one-person corporation.

Golden Oaks therefore lacked the requisite knowledge to bring the action until the appointment of the trustee and the claims against the investors were not time-barred. The case illustrates some of the remedies that are available to a trustee in bankruptcy to recover funds paid to investors in a fraudulent scheme and shows that a trustee will have a reasonable time to commence proceedings in the name of a bankrupt corporation that was operated by a person who was responsible for the fraud.

Contact us

If you have a litigation matter and are in need of legal advice, please do not hesitate to contact James Cook, at 416.865.6628 or jcook@grllp.com.

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