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For information, visit www.IshmaelKhaldi.com (also see *Jewish Tribune*, March 24, 2010, *Most Israeli Arabs not opposed to Israel as a state*, 'proud Israeli' says of his country).

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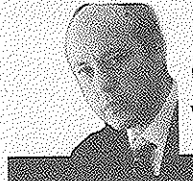
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Victims of fraud and bankruptcy



Charles Wagner

What remedies are left to a victim of fraud when the fraudster goes bankrupt?

Gregory Sidlofsky of our office represented a company that was deceived into loaning money to a company called Credifinance Securities Limited. After we were able to tie up part of the proceeds of the loan, Credifinance declared bankruptcy. In our efforts to recover what remained of the loan, we argued that a constructive trust ought to be imposed on \$310,500 in the fraudster's account that could be traced to the loan. The purpose of the constructive trust was to prevent the unjust enrichment of the bankrupt estate. This case went to Ontario's Court of Appeal and a review of that decision is helpful to those facing a similar dilemma.

To understand this case there are some legal concepts that need be explained. Parliament has set up a process where creditors of a bankrupt are divided into different categories or classes. Secured creditors are in a higher class than unsecured creditors. Therefore, secured creditors get paid first. Unsecured creditors share equally in the remaining assets of the bankrupt estate. In

this case our office argued that sometimes, a strict application of the rules of the Bankruptcy and Insolvency Act is unjust and the courts have jurisdiction to intervene with equitable remedies like a constructive trust.

A constructive trust can be imposed by the courts even if the parties never intended for there to be a trust. It is a kind of lien on property, which judges can use to right an injustice when property or money has been wrongly taken. It is a corrective measure to deal with situations where someone may otherwise be unjustly enriched at the expense of an innocent party.

In this case, our office filed a claim with Deloitte & Touche Inc., the trustee in bankruptcy asserting a property interest in the proceeds of the loan. We argued that what remained of the loan, \$310,500, should be impressed with a constructive trust in favour of our client because the principal of Credifinance, Georges Bennaroch, defrauded our client into loaning the money. The Trustee denied our client's claim. That decision was appealed to the Ontario Superior Court of Justice and was heard by Justice Frank N. Marrocco.

Justice Marrocco found that our client was deceived by Georges Bennaroch and but for the deceit, our client would not have entered into any agreement with nor lent Credifinance \$400,000 and Credifinance would not have had \$310,500 in its bank account. The trustee took the position that

even if there was a fraudulent misrepresentation by Credifinance, it would not allow our client to bypass the Bankruptcy and Insolvency Act because, the trustee argued, there is no special status accorded to the victim of a fraud. In other words – victims of fraud are just like any other creditor. In this case, Justice Marrocco disagreed. He imposed a constructive trust on the \$310,500 remaining in Credifinance's bank account that could be traced to the loan. Deloitte & Touch appealed Justice Marrocco's decision to the Ontario Court of Appeal.

At the Ontario Court of Appeal, Gregory Sidlofsky of our office argued, on behalf of our client, that the fraud resulted in our client having a property interest in the remaining loan proceeds by way of constructive trust. A property interest would remove the \$310,500 from the assets of the bankrupt estate. Deloitte & Touche again argued that even if there was a fraudulent misrepresentation that induced our client to loan money to Credifinance, it would not allow our client to bypass the strict requirements of the Bankruptcy and Insolvency Act. The Ontario Court of Appeal dismissed the appeal and upheld Justice Marrocco's decision.

There are a number of important conclusions we can draw from the Ontario Court of Appeal's decision. There is no question that the remedy of constructive trust is expressly recognized in bankruptcy proceed-

ings. Depending on the facts of the case, a constructive trust in bankruptcy proceedings can sometimes be used to remedy an injustice. Importantly, in this case the only creditors who were impacted by the court's decision were the principal of Credifinance and his lawyers who were the main creditors of the bankrupt estate.

This decision does not mean that every victim of fraud can successfully obtain a constructive trust over money taken from him by the bankrupt. Imposing a constructive trust is discretionary and the court will consider all of the circumstances including who will be impacted by the constructive trust. But what is clear is that the remedy of constructive trust is a viable argument in bankruptcy cases that can, in appropriate circumstances, trump other creditor's claims.

This short review of the case law should not be taken as legal advice. Based on my experience in dealing with these cases, they often turn on the specific facts. If you have a legal question relating to something similar, you are best advised to seek out competent legal counsel to determine your best course of action.

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