

CITATION: Autoworkers (Ajax) Credit Union Limited v. Cumis General Insurance Company,
2012 ONSC 172
COURT FILE NO.: CV-11-9143-00CL
DATE: 20120118

ONTARIO

SUPERIOR COURT OF JUSTICE

BETWEEN:)
)
AUTOWORKERS (AJAX) CREDIT) Evert Van Woudenberg and James R.
UNION LIMITED IN LIQUIDATION) Cook, for the Plaintiff/Moving Party
(BY ITS LIQUIDATOR, DEPOSIT)
INSURANCE CORPORATION OF)
ONTARIO))
)
Plaintiff) Jamieson Halfnight and Brent Vallis, for
) **the Defendant**
- and -)
)
CUMIS GENERAL INSURANCE)
COMPANY)
)
Defendant)
)
)
)
) **HEARD: October 18 and 19, 2011**

2012 ONSC 172 (CanLII)

CUMMING J.

REASONS FOR DECISION

Introduction

[1] The plaintiff, Autoworkers (Ajax) Credit Union Limited in Liquidation (“Ajax CU”) by its Liquidator, Deposit Insurance Corporation of Ontario (“DICO”), brings a motion for partial summary judgment.

[2] The defendant, Cumis General Insurance Company (“Cumis”), issued fidelity Bond Policy Number 01501339 (the “Bond”) on December 13, 2006 which provided certain coverages to Ajax CU.

[3] Ajax CU was the victim of an internal fraud perpetrated over several years by its general manager, Ms. Elva McCalden (“McCalden”). She suffered a stroke about April 3, 2007 and was unable to return to work. Thereafter, it was discovered that she had improperly and unlawfully diverted monies of Ajax CU to certain uses. She engaged in what might be called an ‘off-book’ deposit scheme, as discussed below.

[4] On November 5, 2007, DICO made an order under s. 294(1) of the *Credit Unions and Caisses Populaires Act*, S.O. 1994, c. 11 (the “Act”), placing Ajax CU under administration by DICO. DICO made a Requisition and Direction on November 8, 2007 that Ajax CU be wound up pursuant to s. 298 of the *Act*. DICO became the liquidator of Ajax CU.

[5] DICO made a claim under the Bond against Cumis in respect of claimed losses as a result of Ms. McCalden’s diversion of monies.

[6] Cumis denied coverage under the Bond, claiming that Ajax CU had failed to prove it had suffered a covered loss and that Ms. McCalden’s conduct did not meet the specific requirements for coverage under the “Dishonesty” and/or “Forgery” provisions of the Bond.

[7] Ajax CU is in liquidation because it suffered a serious capital shortfall. DICO had to take it over and make up the loss of capital as guarantor of the deposits. Thus, DICO has two roles in respect of Ajax CU: that of Liquidator of Ajax CU, and that of deposit insurer in respect of members’ deposits. Cumis suggests there is an issue given DICO’s dual roles and implies there may be something untoward because of this; however, in my view, the two roles are distinctive and the fact that DICO wears two hats is of no real consequence to the motion at hand. DICO, as Liquidator, stands in the shoes of Ajax CU and brings this action in that capacity.

[8] Ajax CU submitted a bond proof of loss to Cumis on June 26, 2008 via its Liquidator, DICO, seeking indemnification of \$8,232,236.38 plus \$25,000 for financial audit expenses and a further \$25,000 for records reconstruction, supported by a forensic report prepared by Marcil Lavallee C.A.

[9] A forensic report (the “Deloitte Report”) dated November 2, 2010 by Deloitte & Touche LLP (“Deloitte”) for DICO confirmed that Ajax CU had paid out (via funds advanced by DICO) \$8,112,723 (\$5,404,482.89 in respect of so-called Type A transactions and \$2,708,240.13 in respect of so-called Type B transactions, discussed below, including capitalized and accrued interest) to members to honour the obligations to members represented by Guaranteed Deposit Certificates and related amounts due to Ms. McCalden’s off-book deposit scheme. A member’s Guaranteed Deposit Certificate has an interest rate with a term and maturity date for the repayment of principal and interest.

[10] DICO as Liquidator of Ajax CU brings a motion for partial summary judgment under Rule 20 against Cumis, seeking a declaration that Ajax CU is entitled to the payment of the sum of \$8,112,723 pursuant to the Bond issued by Cumis on December 13, 2006 and pursuant to the Bond Proof of Loss dated June 26, 2008.

[11] Cumis responds to the motion for partial summary judgment by submitting that DICO has not met the onus of demonstrating that there are no genuine issues for trial.

[12] The factual situation underlying the legal issues is very complex and to some considerable extent obscure because of the actions of the wrongdoer, Ms. McCalden. Two forensic accounting firms have provided expert analyses in respect of the financial records of Ajax CU. Deloitte has provided a comprehensive forensic accounting report dated November 2, 2010 for the moving party, DICO. BDO Canada LLP (“BDO”) has provided for Cumis a critique of the Deloitte Report, dated June 6, 2011. Deloitte has provided a supplementary report dated July 27, 2011 in response to BDO’s June 6, 2011 analysis of the Deloitte Report. BDO then provided a supplementary report to Cumis dated August 19, 2011 responding to Deloitte’s position in Deloitte’s July 27, 2011 communication. The two firms take opposing positions as to what is to be drawn from the confusing financial records of Ajax CU. BBCG Claims Service Limited (“BBCG”) also provided an investigative report to Cumis dated May 5, 2009.

[13] There is a significant conflict in the evidence of the forensic accountants in their analyses as to the reasons for the loss of capital of Ajax CU and whether any part or all is a covered loss under the Bond.

[14] In my view, the forensic accounting evidence is critical to a determination of the issues as to whether there is a covered loss under the Bond and, if so, the proper quantification of that loss. This evidence cannot be fairly evaluated without the experts’ *viva voce* testimony at a trial with their analyses and reports reviewed in detail, elucidated upon, and tested by cross-examination.

[15] After considering the submissions, I find that the moving party has not demonstrated that there are no genuine issues for trial. The moving party has not provided a level of proof that demonstrates a trial is unnecessary to truly, fairly and justly resolve the issues. Accordingly, the summary judgment motion is to be dismissed.

[16] Having stated that conclusion at the outset, I emphasize the obvious, namely, that the determination of all facts and legal issues is properly left to the determination of the trial judge. However, given the complexity of the issues, I have set forth at some length my analysis and comments to elucidate upon the difficult issues for consideration. My reasons follow.

The Evidence

The Background

[17] Section 151 of the *Act* from 1995 to 2009 placed a requirement on every officer or employee of a credit union who receives or who has charge of money to furnish a bond for the “...due accounting of money that he or she receives”. There was some argument as to the impact, if any, of this provision to the factual situation at hand.

[18] The practice in respect of credit unions has been that bonding was provided through the Credit Union Bonding Program (as in the instant situation) rather than require individual bonds

from each officer or employee of each credit union in Ontario. The Bond at hand is the relevant insuring agreement to the issues on this motion. The Bond itself determines its coverage. In my view, s. 151 of the *Act* does not, in itself, impose any obligation upon Cumis and the statutory provision has no relevance to the case under consideration.

[19] An investigation over April 2007 to April 2008 determined that Ms. McCalden had engaged in two types of misfeasance. These, in effect, amounted to a substantial off-book deposit scheme.

[20] First, in respect of some monies received by Ajax CU for deposit, she failed to credit the paying member's account with the deposited funds (a so-called "Type A transaction"). She would issue a Guaranteed Deposit Certificate ("GDC") in the usual form to a depositing member upon receipt of the deposit funds, however, the deposit was not in fact credited to the depositing member's deposit account as a deposit liability of Ajax CU. Hence, while the received deposit at least generally appears to have gone into Ajax CU's bank account as an asset of Ajax CU, Ms. McCalden failed to record a corresponding liability of Ajax CU to the depositing member.

[21] Second, Ms. McCalden sometimes removed previously correctly credited amounts from a member's deposit account without payment to that depositing member (a so-called "Type B transaction"). A member who had in hand a GDC from an originally properly credited deposited transaction would not be aware of the subsequent removal of the deposit credit from the member's account in the records of Ajax CU. That is, the member's deposit account was altered to no longer show a deposit liability even though there had not been any repayment to the depositing member. Ms. McCalden would use the funds in question for a purpose unrelated to the member who had made the deposit. For example, Ms. McCalden might credit the monies taken to the benefit of another member by reducing or eliminating a liability of that member to Ajax CU (for example, by reporting a loan as having been paid), that is, a member unrelated to the depositing member.

[22] In respect of both Type A and Type B transactions, Ms. McCalden diverted the misdirected deposit funds to other uses. For example, she sometimes used monies for purported "repayments" on loans outstanding to members unrelated to the depositing member. She sometimes credited payments to unrelated loan accounts of members to make them appear current. There were payments for disability premiums on loans to delinquent members. Interest was paid to off-book GDC holders, that is, to members who had received GDCs but whose deposit was not properly credited to the depositing member. Monies were also paid for partial or full redemptions of off-book GDCs. There is also evidence which suggests that Ms. McCalden misappropriated some monies received by way of off-book deposits for the personal use of herself and/or her husband.

[23] Cumis does not dispute that Ms. McCalden knowingly made the incorrect and improper entries in the records.

[24] It seems from the evidentiary record that one of the reasons Ms. McCalden carried on her unlawful scheme was to avoid closure of Ajax CU by its statutory regulator. That is, her fraudulent recordkeeping disguised the fact that Ajax CU was not meeting its capital requirements.

[25] The overall impact of Ms. McCalden's recordkeeping misdeeds resulted in the liabilities of Ajax CU being understated and the assets and income of Ajax CU being overstated. In the result, there was a hidden significant deficit in Ajax CU's regulated capital position for each year from about 1996.

[26] When an off-book GDC holder came to cash in the GDC, Ms. McCalden would simply use new off-book funds to meet the cash requirement. If the off-book GDC holder sought to renew the GDC, Ms. McCalden would issue another GDC. She issued renewal GDCs to members whose deposited funds had already been misdirected and for which the records of Ajax CU did not show any deposit liability. Ms. McCalden was apparently able to misrepresent the financial condition of Ajax CU so as to avoid discovery by Ajax CU's auditor and board of directors, such that there was not intervention and closure by the regulator, Financial Services Commission of Ontario ("FSCO"), and the deposit insurer, DICO.

[27] There is not any dispute by Cumis that Ajax CU suffered a capital shortfall and therefore in that sense had a loss in the claimed amount. Rather, the real issue raised by Cumis in its defence is whether any part or all of this loss was covered under insuring provisions of the Bond.

[28] Cumis does not dispute the quantum of the calculation of the net claim of \$8,112,723 (after taking into account the \$50,000 deductible). It is also not disputed that the loss was discovered in the policy period for which the Bond provided coverage or that the claim of Ajax CU was made in a timely manner.

[29] There is also common ground that, if there is otherwise a covered claim under the Bond, Ajax CU is entitled to \$25,000 for each of "Audit Expense" and "Records Reconstruction".

The Bond

[30] The fidelity coverage of the statutorily mandated Bond in force and effect includes coverage for:

DISHONESTY: Direct loss of PROPERTY resulting from dishonest or fraudulent acts of any EMPLOYEE...committed alone or in collusion with others with the manifest intent to:

1. Cause the INSURED to sustain such loss; and
2. Obtain FINANCIAL BENEFIT for any person or entity or for oneself.

(“Financial Benefit” is defined to mean “Financial gain other than salaries, fees, bonuses, promotions, awards, profit sharing, pensions or other benefits earned in the course of employment.”)

[31] There is an Exclusion in respect of “Unfaithful Performance”, defined as:

Failure to perform duties, including but not limited to:

- (a) any deliberate or intentional act or omission in disregard of statutes, bylaws, regulations, lawful rules or instructions governing or directing the performance of duties; or,
- (b) any improper, improvident, unauthorized, illegal or reckless lending, even if such loans have been subject to concealment, alteration, falsification, amendment, manipulation or destruction of records, except where such loans have been procured directly by any EMPLOYEE...with the active and conscious purpose to cause the INSURED to sustain such loss and to obtain a FINANCIAL BENEFIT for any person or entity or for oneself.)

[32] The Bond also contains an exclusion for “Indirect Loss”, which provides that the Bond does not apply to loss due to “indirect or consequential loss or damage,...or loss of ...interest on Property”.

[33] Coverage is also included in respect of:

FORGERY: Loss directly resulting from the INSURED having, in good faith, paid or transferred any PROPERTY:

- 1. in reliance upon a FORGERY of SECURITIES...to the extent the FORGERY causes the loss.

“Forgery” is partially defined as being any of the following:

- 1. any imitation which is intended to deceive and to be taken as an original;

....

[34] Cumis takes the position that there is insufficient proof that Ms. McCalden’s off-book scheme caused any “direct loss” to Ajax CU and that the coverages for “DISHONESTY” and/or “FORGERY” were not engaged. Cumis argues that to prove a loss triggering the Bond it is necessary to establish a loan-by-loan linkage to each improperly recorded member deposit and then examine each loan to see if covering up on the loan resulted in an actual loss.

[35] Cumis submits that triable issues include:

- (i) whether DICO has proven what loss it actually suffered to be considered for coverage;
- (ii) whether the requirement for “Manifest Intent” under the Employee Dishonesty coverage has been met;
- (iii) whether the GDCs are “Forgeries” within the meaning of the Bond;
- (iv) whether the plaintiff has failed to mitigate its loss; and
- (v) whether the exclusion for Indirect Loss is applicable.

Analysis

[36] DICO’s position on this motion amounts to the assertion that there is a proven covered loss by showing simply that Ms. McCalden incorrectly and dishonestly off-booked the receipt of certain term deposit monies on the accounting records of Ajax CU coupled with the fact that there is ultimately an undisputed overall capital shortfall to Ajax CU of \$8,112,723.

[37] Cumis disputes this assertion on the basis that money did not necessarily leave Ajax CU at the point in time of the incorrect entry in respect of an inflow of funds. Cumis asserts, in effect, that it is not proven that Ms. McCalden’s dishonest bookkeeping caused losses or at least caused all of the claimed losses. Cumis says that the causation of losses depended upon what Ms. McCalden was doing with the monies and that a detailed tracing of all monies is a prerequisite to determining if there are covered losses.

[38] In my view, with respect, both sides somewhat overstate the facts in asserting support of their respective positions.

[39] Ajax CU had an overall capital loss of some \$8 million at the point of going into liquidation. Ms. McCalden’s dishonesty in recordkeeping arguably led to at least a considerable part of this loss. It is true, as Cumis emphasizes, the physical loss of monies did not take place until there was an outflow of funds from Ajax CU’s coffers. But, it seems certain that there were outflows at different points in time in conjunction with the dishonest recordkeeping with the ultimate overall known loss of some \$8 million. Moreover, but for the dishonest recordkeeping, the increasing capital deficiency of Ajax CU would have been known at a much earlier date. Ms. McCalden’s continuing dishonesty disguised the increasing capital losses.

[40] I do not agree with Cumis’s assertion that a specific tracing of all monies must necessarily be determined before the issue of causation of loss can be adjudicated upon. I disagree with their assertion that the actual use of the missing funds has not been determined without a specific tracing in respect of each and every member account. In my view, a court may be able to make a reasonable inference based upon a preponderance of evidence or balance of probabilities basis as to the quantification of the loss to Ajax CU due to Ms. McCalden’s dishonest recordkeeping.

[41] It is arguable that, to the extent Ms. McCalden made unjustified transfers of off-book deposits through recordkeeping entries as being payments by members in satisfaction of loans, there was a covered loss.

[42] However, the evidence suggests that it is probable that some of these outstanding loans were improvident when first made, or were owed by insolvent members, and would realistically not have been collectible by Ajax CU.

[43] There is some suggestion of improvident lending and generally inept credit practices at Ajax CU while it was under Ms. McCalden's direction and control. A reasonable inference is that, in part, Ms. McCalden's purpose in mis-booking deposits was to disguise the existence of under-performing loans.

[44] Mr. Art Goguen, a principal of BBCG, the investigator on behalf of Cumis, found that the appearance of a relatively stable loan portfolio was the result of a concerted effort by Ms. McCalden to "re-write" delinquent loans and fund loan payments with money collected from the off-book term deposits. BBCG conducted an interview of Ms. McCalden on September 26, 2007 in which she said that the off-book monies were redirected to paying off loans.

[45] DICO also submits that improper uses included Ms. McCalden taking monies of Ajax CU directly for her own personal use and gain. Cumis argues that there is no proof that the monies flowing through Ms. McCalden's bank accounts (including credit cards) were the credit union's own monies.

[46] In my view, the evidence presented on this motion suggests, on a balance of probabilities, that it is reasonable to infer that Ms. McCalden used some of the monies in issue for her own personal use.

[47] Ms. McCalden reportedly had a very modest annual salary with no record as to other significant sources of income. Yet she made deposits of \$311,494 to her personal bank account from no identifiable source, including \$94,480 in cash. She also made deposits of some \$76,635 to her personal account at Ajax CU from no identifiable source, used these monies to buy AMEX Travelers' cheques and spent in excess of \$228,000 on personal AMEX cards between April 2003 and April 2007 on travel, jewellery and other purchases of a personal nature.

[48] There is a vague suggestion, apparently from Ms. McCalden's daughter, that Ms. McCalden inherited some money at one point and that she had won \$50,000 in a lottery draw.

[49] However, Ms. McCalden did not defend a civil action brought against her alleging breach of contract, negligence and breach of fiduciary duty with the result that Ajax CU has a judgment against her for \$8,232,236.38. A certificate of litigation has been registered against her only known asset, her home, transferred to her children for no consideration at about the same time as the investigation into her activities commenced.

[50] It is also noted incidentally that of some 174 credit unions in Ontario who are insured under the Cumis “Master Policy” in respect of the Bond coverage for “Dishonesty” only Ajax CU, apparently due to the initiative of Ms. McCalden, paid an additional premium to raise the limit of coverage from \$10 million to \$15 million. It would appear that Ms. McCalden (who controlled the management of the funds of Ajax CU) was concerned that her dishonesty might result in a claim that would test a coverage limit of \$10 million. A reasonable inference is that she knew full well that her actions were causing, or at least contributing to, significant losses being incurred on the part of Ajax CU.

[51] Cumis emphasizes that, even if DICO has proved its case on a balance of probabilities, DICO does not succeed on a motion for summary judgment if Cumis can demonstrate that it is not “beyond doubt” that there is a genuine issue for trial. This is a summary judgment motion and the moving party must provide a level of proof that demonstrates that a trial is unnecessary to truly, fairly and justly resolve the issues.

[52] Cumis admits that, with respect to any money demonstrated to be stolen by Ms. McCalden, the dishonest or fraudulent requirement in the “DISHONESTY” insuring agreement is met and, to the extent she removed those funds from Ajax CU, there would be a direct loss to which the Bond provides coverage.

[53] However, Cumis asserts that there is no money lost merely by altering accounting records. Cumis asserts that a deposit to an unrelated member’s loan account provides no benefit to that member if the member was never going to repay the loan. As well, it may be arguable that Ajax CU on balance has not overall had a loss of money if it receives payment through off-book deposit monies by way of a bookkeeping credit for an uncollectable debt from a member. Ajax CU will eventually have to repay that depositing member in respect of its off-book GDC. However, Ajax CU has kept the monies received through repayment of a loan in respect of which it would not otherwise have recovered.

[54] In the circumstances, it seems impossible to know whether or not a debtor was never going to repay a debt. Cumis in effect asserts that DICO must prove a negative. At the least, it is evident that, in entering into the borrowing, a debtor has both promised to repay the loan and is also legally obligated to repay it. By receiving a credit against the outstanding loan via the impropriety of Ms. McCalden and hence, the partial or complete discharge of the legal obligation to repay, the member arguably obtained a “FINANCIAL BENEFIT”. This caused Ajax CU to sustain a corresponding direct loss, because Ajax CU was obliged to repay eventually the GDC of the member whose funds gave rise to the misappropriated deposit.

[55] For example, assume a depositing member A gave \$100 to Ajax CU in exchange for a GDC with a \$100 face amount. Ajax CU has an asset of \$100 and a corresponding liability to member A through the issued GDC.

[56] However, if Ms. McCalden were to have taken the \$100 deposit off-book (either by way of a Type A or Type B transaction) and credited the \$100 received against a \$100 loan owed by

member B, then Ajax CU has lost an asset (the debt owed by member B) of \$100. Ajax CU continues to have the \$100 liability to member A, which obligation will have to be honoured when the GDC held by member A comes due. (This example ignores the accruing interest on the GDC to member A and the loss to Ajax CU of ongoing interest owed by member B on the loan).

[57] The effect is that the off-book deposit scheme and the diversion of those funds caused Ajax CU to understate its loan losses, artificially reduce its loan receivables, overstate the revenue from interest on loans, understate the interest liability to depositing members and overall, concealed the true financial picture and viability of Ajax CU.

[58] DICO also submits as an alternative basis for recovery that the “Forgery” provision of the Bond is operative to provide coverage of the loss caused by Ms. McCalden. However, it would seem that payment by Ajax CU on a GDC which bears the signature of Ms. McCalden is not a payment because of a forgery of a GDC (even though there is no member deposit liability recorded in the records of Ajax CU, given that the GDC is off-book).

[59] The evidence suggests the GDC in the case of either a Type A or Type B transaction in itself was authentic, as Ms. McCalden was authorized to issue and sign GDCs on behalf of Ajax CU and to receive the deposit monies paid. What was wrong was the fact of Ms. McCalden’s dishonesty in the use of the monies received by the issuance of the GDC.

[60] Deloitte contends that a loss occurred in respect of a Type A transaction on the date the original GDC transaction was recorded incorrectly in Ajax CU’s general ledger. In Deloitte’s view, the loss in respect of a Type B transaction was incurred on the date that the liability to the depositing member was removed by debit memo and transferred to the benefit of another member’s account.

[61] BDO and Cumis attribute the non-recording of the liability to depositing members to incorrect accounting entries which do not involve the actual flow of funds as no monies have actually left Ajax CU’s bank account.

[62] Deloitte and DICO assert that the *substance* of the transaction to repay non-performing loans is to transfer off-book deposits from Ajax CU’s bank account to the credit of the delinquent borrowers and then return the monies to Ajax CU as ‘loan repayments’.

[63] Deloitte gives as its overall conclusion (July 27 supplementary report, 2011 p. 10):

We have clearly determined that there is no other liability account or other credit account where these off book GDC’s were recorded and that these were clearly off book deposits....In order to have an off book liability, there needs to be an off book asset. In this case, it is this cash that, in substance, was transferred out of the Credit Union in various forms to cover losses. These losses consist of bad debts, unrecorded interest expense and other unsupported cash disbursements. In addition, further advances (money leaving the Credit Union) were made to

members who were not paying their existing delinquent loans at the Credit Union. These new advances were in essence a loss at the time they were made....

The Law

[64] A fidelity bond is an insurance contract. Hence, in giving effect to reasonable expectations created by the contract of insurance, the coverage provisions of the Bond are properly construed broadly while exclusions are to be interpreted strictly.

[65] Extensive reference was made by counsel for both parties to the recent decision by the Court of Appeal in *Iroquois Falls Community Credit Union Ltd. v. Co-operators General Insurance Co.* 2009 CarswellOnt 2286 (C.A.) ("*Iroquois Falls*"). That case also dealt with the issue as to whether losses due to an employee's misconduct were covered by a fidelity insurance bond issued in favour of a credit union, now in liquidation. The appeal was in respect of the summary judgment granted by the motion judge in favour of the credit union.

[66] R. G. Juriansz J.A. reviewed the issues relating to the interpretation of the bond, the provisions of which appear to mirror those of the Bond in the motion at hand.

[67] The insurer in *Iroquois Falls* submitted (as does Cumis in the case at hand) that the credit union sustained no loss because "no money went out the door" but was simply transferred internally. This argument was rejected (at para. 37) because the dishonest employee had actually physically removed cash from the credit union's vault before then later using the cash to make deposits with the cash into various members' accounts.

[68] In the case at hand, there were no immediate physical transactions of cash at the moment of the first step of a Type A or Type B transaction. However, with the misdirection of money by Ms. McCalden in either type of transaction, there was, arguably, a direct loss as the deposited money improperly stood to the credit or benefit of a non-depositing member to the loss of Ajax CU as of the point of the transfer of the money on the books.

[69] The evidence suggests that sometimes the money physically left Ajax CU at the point of Ms. McCalden's diversion (for example, if she were to have diverted the money for her own personal use) while at other times, the money was simply 'transferred' on the books of Ajax CU to the credit of another member (for example, in 'payment' of a loan in default.)

[70] Moreover, it is arguable that in all events as of the date of discovery of Ms. McCalden's dishonesty, there was a known and certain quantifiable direct loss.

[71] It is also arguable that, but for Ms. McCalden's fraudulent acts, the losses occurring due to delinquent loans would have been ascertained several years earlier with the result that the overall eventual capital loss would have been quantitatively much less than the \$8,112,723. seen through the liquidation. Ms. McCalden's dishonesty disguised delinquent loan losses from about 1996 onwards which subterfuge allowed a perpetuation of further losses until her stroke in 2007. It is arguable that her dishonest acts were a direct cause of at least those losses which occurred

after Ajax CU would have been otherwise shut down because of its accumulating capital shortfall which would have been apparent through proper and transparent bookkeeping.

[72] Deloitte states (at p. 11 of its July 27, 2011 supplementary report):

...[T]he scheme allowed the Credit Union to use the off-book funds to conceal losses and to continue to perpetrate the off book deposit scheme. BBCG clearly summarizes this in...their report dated May 5, 2009...by the following statement in relation to loan delinquencies, “*the appearance of a relatively stable loan portfolio was the result of a concerted effort by the defaulter to “re-write” delinquent loans and fund loan payments with money collected from off-book term deposits.*”

[73] As Deloitte also stated (at p. 4 of its July 27, 2011 supplementary report):

...Since losses incurred by the Credit Union were not recorded, the true financial picture of the Credit Union was misrepresented (its operating results and assets were overstated and its liabilities were understated) and therefore the Credit Union was able to continue to operate and accept additional deposits that were used to perpetuate these improper activities and consequently led to further losses.

[74] It is arguable that any chance of recovery through going against members who had benefited from her dishonesty (such as by now seeking the repayment of their loans), is a matter through subrogation to the rights of the insured upon payment of the loss by the insurer.

[75] The insurer in *Iroquois Falls* also argued (as does Cumis) that there was no direct loss to the credit union through the extension of unauthorized loans to members who had real obligations to repay the money they had received. This submission was rejected in *Iroquois Falls* because the credit union suffered a direct loss when it paid out money it would not otherwise have paid out and ended up with less money (at para. 48). The insurer’s submission (like that of Cumis) that the credit union could always seek repayment of an unauthorized loan until it could not be repaid was also rejected as having no import (at para. 50).

[76] In the case at hand, the evidentiary record as to the overall loss is arguably an established fact and the collection on any unauthorized loans or credit and forgiveness of existing loans seems extremely doubtful. Moreover, as stated by Juriansz J.A. (at para. 54), the question is not whether the loss can be recovered but, rather, whether it is insured under the bond. As well, as already stated, the insurer has the right of subrogation to the rights of the insured credit union to recover a covered loss.

[77] Ms. McCalden intentionally failed to credit members with deposit amounts in the records of Ajax CU (Type A transactions) or intentionally removed existing credits from members’ accounts without repaying the member whose account lost the credit (Type B transactions). The

monies represented by the claimed loss are arguably covered by her fraudulent actions in respect of these two types of transactions.

[78] Ajax CU arguably suffered a “direct loss” at the point in time when an asset being carried on the books was reduced, irrespective of whether it is possible to subsequently reverse the entry and attempt collection from a member who benefited from the malfeasance.

[79] The insurer in *Iroquois Falls* submitted that the wrongdoer in that factual situation, as she stated in her evidence, did not intend to cause loss to the credit union and, therefore, she did not have the “manifest intent” to cause loss or, at the least, that whether she had such an intent is a genuine issue for trial.

[80] Juriansz J.A. emphasized (at para. 76) that:

...the language of the bond...indicates that the focus must be on the employee’s intent in doing the act that caused the loss...Where the act that caused the loss was an interim step in a greater plan, subsequent acts taken or planned by the employee are quite irrelevant. If there is any ambiguity in this, and I see none, it must be resolved in favour of the insured.

[81] The employee’s “intent” within the meaning of the Bond pertains to the immediate loss s/he caused. Such “intent” is to be distinguished from the desire or “intent to achieve an ultimate outcome” (paras. 83 and 84). Whatever Ms. McCalden’s desire was (such as, perhaps, in part to keep Ajax CU from being closed down, or just to help certain members in difficult times with loans in default), the only reasonable inference is that she knew she was using Ajax CU’s monies in a way it did not want the monies to be used and it was very improbable it would somehow be repaid or recovered. As Juriansz J.A. stated in *Iroquois Falls*, “the direct loss...is the extending of money that [the credit union] otherwise would have kept on hand” (para. 93).

[82] The evidence on this motion suggests that Ms. McCalden had a manifest intent through her fraudulent actions in respect of the off-book scheme to obtain a personal benefit to herself in respect of some of the monies and to obtain a financial benefit for others in respect of some of the monies.

[83] The intentional making by Ms. McCalden of false or fictitious entries into the records of Ajax CU constitutes dishonest and fraudulent acts on her part. Arguably, they were committed by her with the manifest intent to cause Ajax CU to sustain a direct loss of money and obtain a corresponding financial benefit to herself (to the extent she took money for her personal use) and to other persons to the extent she gave fictitious credits against outstanding loans.

[84] Ms. McCalden’s “manifest intent” is reasonably inferred from her conscious awareness of what she was doing and the evident certainty to her of the consequences resulting from those acts.

[85] Cumis speculates that there are other potential causes of the ultimate shortfall in capital of Ajax CU such as a declining member base, normal loan losses and bad debts, insufficient interest rate spread and/or a substandard credit-granting process, unrecorded interest expense and other unsupported cash disbursements or loan advances to members in delinquency on prior loans. Such factors may well have contributed to an underlying reason for Ms. McCalden's fraudulent actions, being to disguise the developing capital shortfall.

[86] There is some suggestion that Ms. McCalden engaged in improvident lending, including re-writes for members in financial trouble, indiscriminate interest rate breaks, subpar credit checks and failure to take proper security on loans. The Bond's exclusion for "Unfaithful Performance" provides that there is no coverage for losses arising as a result of "improper, improvident, unauthorized, illegal, or reckless lending". Cumis argues that each of Ajax CU's loan losses has to be analyzed on a loan-by-loan basis for coverage purposes. This would seem to be a difficult, if not impossible task; however, this issue is best addressed fairly with the forensic accounting evidence afforded by a trial.

[87] The expert for Cumis, BDO Dunwoody, asserts (at paras. 46, 48-49) that the mis-booking of deposits did not, in itself, create a loss but rather simply misrepresented the inflow of funds on the books of the credit union. BDO Dunwoody says that there is no evidence of the actual outflow of funds from Ajax CU as the result of Ms. McCalden's actions. That is, Cumis says the actual use of the funds has not been determined. However, it is known at the end of the saga of Ms. McCalden that Ajax CU has an admitted capital shortfall of more than \$8 million.

[88] Cumis asserts that to determine what, if any, loss was caused by Ms. McCalden's malfeasance, it is necessary to determine what outflows of funds there were over time and the cause of each. Cumis asserts that DICO must trace, examine and analyze the actual means by which Ajax CU's capital was depleted over time.

[89] It is arguably a reasonable inference to conclude that the overall loss was a result of Ms. McCalden's dishonest redirection of monies through her recordkeeping even if specific amounts deposited cannot be traced as to a specific end use. The very reason this tracing cannot be easily done is because of the intentional wrongdoing of Ms. McCalden in her fraudulent recordkeeping.

[90] Cumis also asserts that only a direct loss is a covered loss and that the Bond expressly excludes coverage for indirect or consequential loss or damage. Therefore, Cumis raises an issue as to whether there is an exclusion from a covered loss under a fidelity bond in respect of interest paid on defalcated funds. Moreover, Cumis asserts that Ms. McCalden's payouts to off-book deposit holders are simply a consequential loss. Cumis submits this characterization is particularly apt given the evidence that Ms. McCalden's mis-booking activities reach back to years before 1996.

[91] Cumis also submits there is a genuine issue as to whether DICO has failed to take reasonable steps to mitigate the loss of Ajax CU. It appears DICO has not made efforts as Liquidator to make recovery on member loans improperly discharged by Ms. McCalden's

fraudulent actions. DICO responds by saying that some borrowers at Ajax CU are bankrupt and, in any event, that the statute of limitations is operative given the passage of time.

Disposition

[92] As I stated at the outset of this decision, the factual situation underlying the legal issues in this case is very complex and, to some considerable extent, obscure because of the actions of the wrongdoer, Ms. McCalden.

[93] In my view, the forensic accounting evidence is critical to a determination of the issues as to whether there is a covered loss under the Bond and, if so, the proper quantification of that loss. This evidence cannot be fairly evaluated without the experts' *viva voce* testimony at a trial with their analyses and reports reviewed in detail, elucidated upon, and tested by cross-examination.

[94] Moreover, as Juriansz J.A. states in *Iroquois Falls* in allowing the appeal to dismiss the summary judgment motion, "On a summary judgment motion, where significant evidence, albeit uncontested, is reasonably capable of supporting more than one inference, the motion judge should refrain deciding the issue of fact." (para. 62).

[95] After considering the submissions, I find that the moving party has not demonstrated that there are no genuine issues for trial. The moving party has not provided a level of proof that demonstrates a trial is unnecessary to truly, fairly and justly resolve the issues. Accordingly, the summary judgment motion is dismissed.

[96] If the parties cannot agree upon the issue of costs, submissions may be made to me in writing. In such event, Cumis has 15 days to make its submission, with DICO having 15 days to respond and Cumis having five days for any reply submission.

CUMMING J.

Released: January 18, 2012

CITATION: Autoworkers (Ajax) Credit Union Limited v. Cumis General Insurance Company,
2012 ONSC 172
COURT FILE NO.: CV-11-9143-00CL
DATE: 20120118

ONTARIO
SUPERIOR COURT OF JUSTICE

BETWEEN:

**AUTOWORKERS (AJAX) CREDIT UNION
LIMITED IN LIQUIDATION (BY ITS
LIQUIDATOR, DEPOSIT INSURANCE
CORPORATION OF ONTARIO)**

Plaintiff

– and –

CUMIS GENERAL INSURANCE COMPANY

Defendant

REASONS FOR DECISION

CUMMING J.

Released: January 18, 2012