



# Torkin|Manes FOCUS

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SPRING 2007

FOCUS ON COMMERCIAL LEASING LAW

## Leasing fraud: A pre-Enron lesson



David Chaiton

This case took place several years ago, before Enron and Arthur Andersen became infamous household names, but the numerous

legal proceedings it spawned have been resolved only recently. If this case had occurred after the recent spate of frauds made the headlines, it would almost certainly be just as well known.

General Leasing Inc. (GLI) was a Canadian company that leased office equipment – computers, telephone systems, photocopiers and the like – to businesses and individuals. Its founder, Dwayne Nivin, was a charismatic individual who

ran the company in an autocratic manner. Nivin had a tendency to use company funds for some of his personal expenses, including the purchase of several luxury homes in US resort areas.

Nivin was shrewd, intelligent and driven. He successfully took GLI public in the early 1990s, although he remained the dominant shareholder by a considerable margin. He installed a



board of directors that appears to have been only too willing to accept whatever Nivin said, or to turn a blind eye to his activities. Before the considerably more stringent corporate governance requirements of today, this kind of behaviour by a board was not unusual.

Typical of the leasing industry, GLI sold the financial benefits of its leases to “funders” – mostly large financial institutions. The funders perceived the leases as somewhat akin to bonds. They provided a steady stream of income that had a known value over a specific period of time.

GLI’s business plan made sense as long as the lease portfolio continued to grow, the default rate was reasonable and the interest spreads were adequate

to support the infrastructure required to originate and administer the leases to their conclusion. If business began to sour, however, GLI could quickly find itself in trouble. It had a “prompt-pay” arrangement with its funders – which meant that GLI had to pay the funders on a monthly basis, whether or not it had received payments from the lessees.

*(continued next page)*

## Announcement

Torkin Manes is extremely proud to announce the addition of David Chaiton and Jeffrey Alpert to the firm’s newly-created Financial Services and Corporate Recovery Group. David and Jeffrey, who combined bring with them more than 50 years experience in this area, will continue their well-established practices acting for a broad range of clients in the financial services area.

*Please see the enclosed Bulletin for more information on this new development.*

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**Fiasco** (cont'd.)

Although the funders owned the leases, GLI administered all aspects of them. This proved to be a significant mistake. At its peak, GLI had about 250 employees and 44,000 leases with a face value of about \$300 million.

To keep growing, a leasing company has to continue to write new leases, a pressure that can encourage a loosening of the credit requirements for lessees, producing in turn – as might be expected – a higher number of defaults.

A couple of years after going public, GLI found itself in financial trouble for a variety of reasons. One of these was the continuing misuse of company money by Nivin to pay for his extravagant lifestyle. Another was the increasing number of non-performing

leases – a fact GLI neglected to disclose to the funders.

Nivin decided that he would do anything to save his company.

GLI took advantage of the pre-authorized payment system it had with lessees. It took the payment for one month out on the first of that month, but instead of taking the next payment out on the first of the following month, it took it out on the last day of the current month—two payments in one month. Applied to all their leases, this gave GLI a one-time extra \$15 million in revenue. It also saddled the funders with a hidden \$15-million liability. The lessees, if they noticed the aberration at all, would assume they had one fewer payment to make at the end of the lease.

GLI also began kiting cheques, creating false leases, and “double-funding” leases – in other words, selling the benefits of a lease to more than one funder.

During the several years GLI engaged in these fraudulent activities, neither GLI's board nor its auditors raised the alarm.

The scheme eventually fell apart. The trigger in this instance was the appointment of a new chief financial officer who replaced a compliant – and probably collusive – CFO, who had put into action Nivin's commands. The new CFO didn't like what he saw and soon after he assumed the post, GLI, being a public company, had to make a disclosure.

Nivin acted the part of an aggrieved victim. He blamed others for having

blindsided him, and managed to persuade the funders to give him 60 days to fix the problem (during which, by the way, another \$15 million of funders' money was fraudulently misused) and then he acquired protection for GLI under the *Companies' Creditors Arrangement Act*.

Eventually, however, it all came crashing down, as there wasn't enough real revenue to keep GLI afloat. Many creditors and shareholders lost their money. Almost 250 people lost their jobs.

The funders, through a receiver, created a leasing company of their own to administer the healthy leases. That company was eventually sold and is still in business. They also sued the auditors and recovered a substantial amount of their losses.

The biggest lesson from this? If a funder lets a leasing company administer its leases without diligent oversight, the potential for fraud is about as certain as the fox having chicken for dinner if it's left to run the henhouse.

*David Chaiton's business law practice includes equipment financing, leasing, asset-based lending, corporate finance and banking matters. David has been involved in complex bankruptcy and receivership engagements, and represents banks, insurance companies, leasing companies and other members of the financial services industry.*

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**FOCUS** Facts**“Wash your windshield?”**

Not so fast. The Ontario Court of Appeal recently upheld the constitutional validity of Ontario legislation banning “squeegeeing” and soliciting drivers for money on roadways. The Court held that the legislation does not infringe the individual's right to equality or to life, liberty and security of the person under the *Canadian Charter of Rights and*

Is there a topic you would like us to cover in a future issue of Focus?  
Visit [torkinmanes.com](http://torkinmanes.com) and let us know.

## Sweeping changes to the Human Rights Code: How do they affect Ontario employers?



Peter C. Straszynski

The Human Rights Code Amendment Act, 2006, became law last December and is partly in force. The Act introduces sweeping changes

to the human rights system in Ontario, affecting not only the speed and manner of complaint adjudication, but also exposing employers to broader and more onerous remedies.

### The Current "Gatekeeper" System

Currently, the Human Rights Commission receives, mediates, investigates and assesses all human rights complaints in the province. Complaints must be filed within six months of the date a violation of the Human Rights Code (the "Code") is alleged to have occurred.

The commission has the discretion to extend this deadline under some circumstances or it may refuse to deal with a complaint it deems should be dealt with under other legislation over which it lacks jurisdiction. It may also reject complaints that are frivolous, vexatious or brought in bad faith. When a complaint proceeds and is not successfully resolved at mediation or otherwise, the commission conducts an investigation, which typically involves the review of relevant documents and the interview of witnesses. At the end of the investigation, the commission decides whether the facts warrant referral to the Ontario Human Rights

Tribunal for hearing.

This "gatekeeper" function of the commission has historically resulted in chronic congestion and protracted delay of complaints. It is not unusual for complaints to take up to five years—in some cases as long as a decade—from the time they are filed to a decision by the tribunal.

### The New "Direct Access" System

Under the new system, the "gatekeeper" function will be eliminated. Individual complaints will be filed directly with the tribunal, which will process and hear them.

The commission will focus more on its "public interest" responsibilities: investigating human rights issues; intervening in matters before the tribunal; initiating its own applications before the tribunal; and reporting to the people of Ontario regarding the state of human rights in the province. This system of "direct access" to the tribunal is expected to process complaints much faster.

### Human Rights Support Centre

Changes to the system also include the creation of a new, publicly funded, Human Rights Support Centre, which will provide services throughout the province, including advice, assistance and representation for complainants in relation to applications to and hearings before the tribunal.

### The Most Significant New Rules

Under the new system of adjudication, complaints will have to be brought within a year of the event, or events in

question. This deadline is more generous than the previous one, and can be extended in cases where the delay is incurred in good faith and results in no substantial prejudice. The tribunal may conduct inquiries to collect evidence before holding a hearing. It has the power to enter lands and premises without a warrant; to request the production of documents or other things deemed relevant to the investigation; it may question persons on relevant matters and take photographs, video recordings or other visual or audio recordings of the

## Focus Facts

Separating spouses are increasingly using arbitration or mediation-arbitration in settling their family law issues. These alternatives to court allow for resolution in a more timely, cost-effective, private and humane manner. On April 30, 2007 the Ontario Government proclaimed the *Family Statute Law Amendment Act, 2006* and a regulation under the *Arbitration Act, 1991*, significantly changing the rules governing family law arbitrations in Ontario.

Contact any member of our Family Law Group for more information about our mediation, arbitration and collaborative law services.

## Focus Facts

**C**urrently before the Courts: A and B bought a house to renovate and flip. The title was registered in the name of A, who acted as an undisclosed nominee for the real owners, B and C. The title to the property and title insurance were taken out in the name of A, who later made a claim against the title insurance. The insurer denied coverage, taking the position that the failure to disclose the real owners of the property increased the insurer's risk and represented a material non-disclosure by A. The moral: make sure you tell your title insurer and your lawyer who actually owns the property, not just who will take title to it.

*Contact any member of our Real Estate Law Group for more information.*

### Human rights... (cont'd.)

interior or exterior of a place.

The old cap of \$10,000 on awards of damages for "injury to dignity, feelings and self-respect" will be lifted, and penalties of up to \$25,000 may now be imposed for "general violations of the Code." In other words, the mere fact there has been a breach of the Code—aside from any monetary loss or other damages suffered as a result of the breach—may result in a penalty of as much as \$25,000.

### Effect on Wrongful Dismissal Litigation

At present, an employee cannot sue an employer for a breach of the Code and must go to the commission and then the tribunal to seek a remedy. While the court can consider breaches of the Code in determining whether punitive or aggravated damages are warranted, it will not make an award based solely on a breach of the Code. Under the new system, where the court in wrongful dismissal cases finds that there has been a breach of the Code, it will now have the power to make both monetary awards of compensation for losses arising from such breach (including compensation for injury to dignity, feelings and self-respect), and "non-monetary" awards of restitution. It is expected that this "restitution" power may be used by the court to make orders of reinstatement to employment in appropriate cases. This power of reinstatement was not available to the court in the past. The result will likely be a swell of wrongful-dismissal litigation involving allegations of violations of the Code and seeking new and expanded remedies to which employers have not been traditionally exposed.

### When Do the Changes Become Effective?

The date these changes come into effect has yet to be proclaimed. In the meantime, we do know that the following transitional provisions will apply. For six months after the changes come into force, the commission will continue to deal with unresolved complaints filed under the old system. At

any time during this six-month period, a complainant may abandon his or her old complaint and make a new application to the tribunal, which will then be governed by the new provisions of the Code. If the merits of old complaints have not been dealt with by the commission by the end of the six-month transition period, and the complaint has not been withdrawn or settled, complainants will have an additional six months within which to make a new complaint, which will then will be governed by the new provisions of the Code.

We will keep clients and readers informed as more information comes available on when the new Code will become effective.

*Peter Straszynski provides advice to clients in all aspects of labour relations and employment law and represents both private and public sector employers in a wide variety of legal settings.*

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## Partial settlement agreements: What you get and what you



Sudevi Mukherjee

In complex litigation involving numerous parties, there are certain to be at least as many lawyers' opinions on liability, damages and settlement as there are parties. These

differing views may make the likelihood of a timely settlement difficult. Many lawyers overlook, and clients are not aware of, the possibility of entering into what is known as a partial settlement, or "Mary Carter" agreement.

Torkin Manes' lawyers were recently involved in an important case relating to Mary Carter agreements that will be of interest to insurance companies, or anyone who is involved in complex multi-party litigation.

Partial settlement agreements are named Mary Carter agreements after a 40-year-old case, *Booth v. Mary Carter Paint Co.*

The essential features of a Mary Carter agreement are:

- ♦ The plaintiff receives from one defendant a specific amount of money, regardless of the outcome of the trial.
- ♦ The plaintiff places a cap on the liability of the settling defendant at this amount.
- ♦ The settling defendant remains in the lawsuit.
- ♦ The plaintiff agrees not to pursue the non-settling defendants for any amount beyond their own specific liability, in order to protect the settling defendant from any potential cross-claims for

contribution and indemnity from the non-settling defendants.

- ♦ The plaintiff will agree to decrease the amount to be paid by the settling defendant in direct proportion to any increase in the liability of the non-settling defendants.

These agreements allow some of the participants of multi-party litigation to settle their claims, while maintaining the claims against the non-settling participants. The plaintiff achieves partial success and some certainty. In addition, the partial settlement agreement usually brings additional pressure on the remaining parties, facilitating a complete settlement of all the claims.

The case law and The Law Society of Upper Canada's Rules of Professional Conduct require that non-settling defendants be made aware of a Mary Carter agreement, although *the actual dollar amounts need be disclosed to the non-settling defendants*. The particulars of the Mary Carter also have to be disclosed to the Court.

In a recent case successfully argued by Mark Harrington of Torkin Manes, the Court faced a request by a non-settling defendant for full disclosure of minutes of settlement, because it contained both a Mary Carter agreement, and had provisions of full settlement for some defendants. The Mary Carter portion of the minutes were disclosed, but the remainder of the minutes were not. The settlement amounts involving another defendant were blacked out. The non-settling defendant argued that it would be prejudiced if it did not receive full disclosure, but it failed to adduce

satisfactory evidence demonstrating that prejudice. In reality, the non-settling defendant would have gained a substantial tactical advantage if it had known the full details of the settlement, particularly the amounts paid by the fully settling defendants.

In dismissing the motion, the Court held that there was an absence of evidence of prejudice to the non-settling defendant. In the future, it is recommended that if some defendants

### Focus Facts

The Ontario Court of Appeal recently restated what has been the law for many years in Ontario: the two-year limitation period for suing to recover on a demand promissory note runs from the date the note is *made*, not the date of *demand*. In other words, if a note was signed on January 1, 2007, the lender has until January 1, 2009, to sue the debtor to recover the debt (this is subject to exceptions, such as partial payments or written acknowledgements of indebtedness, which restart the two year period). In commercial matters, never assume that the law follows what you perceive to be common sense.

Contact any member of our Commercial Litigation Group for more information.

## Focus Highlights

In April, Laurie Pawlitza was re-elected a Toronto Bencher in The Law Society of Upper Canada's 2007 Bencher election. Laurie accomplished much in her first term and looks forward to the challenges her new four-year term will bring.

**Partial settlement..** (cont'd.) are entering into a Mary Carter agreement, and other defendants are entering into a full settlement, then multiple Minutes of Settlement should be drafted.

*Sudevi Mukherjee is a member of our Insurance Defence Group. Her litigation practice includes property and bodily injury claims in addition to providing opinions on insurance coverage issues.*

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### FOCUS ON BUSINESS LAW

## Global expertise and counsel – Torkin Manes and the International Alliance of Law Firms



Darryl T. Mann

In 1990, Torkin Manes and a few other leading law firms around the globe founded the International Association of Commercial Lawyers.

The objective of the organization was to enable its members to provide their clients with access to legal services and counsel worldwide. Since its inception, the association has grown to more than 50 members in about 40 countries and is now known as the International Alliance of Law Firms.

Member firms are located in major economic and geographical centres in the Americas, Europe, Middle East, Asia, Africa, and the Pacific Rim and are

able to provide swift and effective local counsel in their jurisdictions.

Clients looking to enter a foreign marketplace or to become involved with foreign parties face unique challenges and require local legal counsel who can offer the specialized knowledge and expertise to guide them through the challenges and issues that are encountered in a foreign jurisdiction. In addition to representing other members and their clients in Ontario, Torkin Manes



INTERNATIONAL  
**ALLIANCE**  
OF LAW FIRMS

has the ability to refer our clients to other Alliance members around

the world. From assisting our clients in all aspects of transactions or disputes, to providing entrées to local authorities, tax structures, and introductions to other professionals, our membership in the Alliance provides our clients with access

to effective counsel and the benefit of local knowledge and relationships.

Our membership in the Alliance, enables our clients to find integrated solutions to all of their business requirements and issues, both domestically and abroad.

*For additional information regarding the Alliance or its global membership, please visit [www.ialawfirms.com](http://www.ialawfirms.com).*

*Darryl Mann is a partner of the firm, and President of the International Alliance of Law firms. He can be reached at 416 777 5407, or [dmann@torkinmanes.com](mailto:dmann@torkinmanes.com).*

## Factoring: What is it, and is it right for your business?



Jeffrey Alpert

For many growing businesses or for businesses experiencing a short-term cash-flow squeeze, traditional bank financing doesn't always provide the best option. One alternative for your business is accounts receivable financing, also known as "factoring." Instead of waiting for a customer to make payment on an invoice, a business can sell its accounts receivable to a factoring company at a discount and receive an immediate cash advance. However, as in most areas of the law, there are potential pitfalls that can best be avoided with the assistance of legal counsel. A recent Ontario Superior Court case illustrates the limitations and risks involved in this type of financing.

There are two main types of factoring — recourse and non-recourse. In recourse factoring, the business selling the receivable to the factoring company guarantees it will repurchase the account from the factoring company in the event the customer fails to pay. In the case of non-recourse factoring, the factoring company assumes the risk of non-payment, subject to certain exceptions.

The typical documentation for accounts-receivable funding involves a factoring agreement (or receivables purchase agreement, as it is sometimes

called); a notification letter to the customer; security in favour of the factoring company (such as a general security agreement or a general assignment of book debts); and a financing statement for the registration of the factoring company's security under the *Personal Property Security Act* (the "PPSA"). In certain cases, the principals of the seller may also be required to provide personal guarantees in favour of the factoring company. It may also be necessary for the factoring company to enter into priority agreements (also called intercreditor agreements) with the other secured creditors of the seller in order to establish that the factoring company has first priority with respect to the seller's accounts receivable.

In the recent case of *2811472 Canada Inc. c.o.b. Acorn Partners v. Royal Bank of Canada*, Mr. Justice Forget of the Superior Court of Ontario had to decide a priority dispute between a factoring company and a bank. Mr. Justice Forget decided that a sale of accounts receivable pursuant to a factoring agreement constituted a "security interest" within the meaning of the PPSA, as opposed to a true sale of the invoices involved. As such, it was necessary for the factoring company to register a financing statement against the seller under the PPSA in order for the factoring company to "perfect" (i.e., protect) its security interest in the accounts receivable. Having failed to do so, the factoring company lost priority to the bank, which had properly registered

its security under the PPSA.

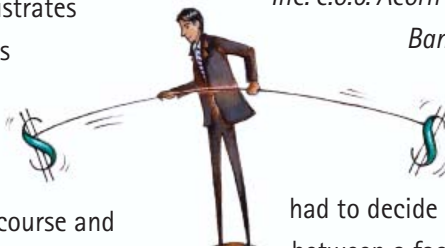
In the course of his decision, Mr. Justice Forget quoted the following description of factoring, which will be helpful in defining the relationship in future cases:

"Factoring is a legal relationship between a financial institution (the factor) and a business concern (the client) selling goods or providing services to trade customers (the customers) whereby the factor purchases the client's book debts either with or without recourse to the client and administers the client's sales ledger."

If you are interested in learning more about accounts-receivable funding, please contact any member of our Banking Law Group.

*Jeffrey Alpert acts for banks and other lenders in commercial loan transactions secured by real estate and personal property. He has expertise in asset-based lending, including receivables purchase financing. His practice also includes corporate and business law.*

*Jeffrey can be reached at 416 777 5418, or [jalpert@torkinmanes.com](mailto:jalpert@torkinmanes.com).*



# Torkin Manes Update

## NEW PARTNERS

We are pleased to announce that Glen Eddie and Scott Martin were admitted to the partnership, effective January 1, 2007.

## NEW LAWYERS

We are also pleased to announce that the following lawyers have joined the firm.

David Chaiton – *Business*

Irit Gertzbein – *Wills and Estates*

Belinda Godwin-Rossi – *Family*

Patty Keroglidis Karmiris – *Real Estate*

Sabina Mexis – *Business*

Tanisha Tulloch – *Litigation*

## ANNOUNCEMENTS AND NEWS

Lorne Wolfson and Laurie Pawlitz were both named a Best Family Lawyer by The Best Lawyers in Canada.

Lorne Wolfson, Loretta Merritt, Janice Grevler and Lisa Corrente presented on "Current Legal Issues - What Mental Health Professionals Need to Know" for Leading Edge Seminars on May 24.

On May 10, Linda Godel co-chaired the CBA/OBA National Charity Law Symposium.

Duncan Embury presented an invited lecture on "Preparing Plaintiff's Medical Experts for Trial" in a Medical Negligence Action on April 27. As well, Duncan was re-elected to serve a three-year term on board of directors of the Ontario Trial Lawyers Association.

On April 24, Gregory Hersen chaired the OBA Construction Law Program titled, "Alternative Financing and Procurement:

Ontario's New Project Model Explained and Explored."

On April 18-19, Rosemary Grenside presented, and Sidney Troister chaired, the fourth annual Real Estate Law Summit for The Law Society.

Sidney Troister has been granted the designation Chartered Arbitrator by the ADR Institute of Canada.

In April, Jeffrey Simpson presented a paper on "Personal Bankruptcy as it Affects Real Property," at the OBA's Personal Bankruptcy Seminar.

At its recent Annual General Meeting, Darryl Mann was elected as the President of the International Alliance of Law Firms. Darryl was also a speaker on the topic "Merger, Association or Partnership Strategy" at the international SENALAW Conference in May in Sao Paulo, Brazil and was a guest lecturer at the Mackenzie University College of Law in Sao Paulo on the topic of "The Business of Law Firms: Strategies for Success in the Global Marketplace."

Valerie Edwards has been appointed chair of the Class Proceedings Committee, a statutory body that provides financial support for class actions in Ontario.

In March, Lorne Wolfson presented a paper titled "The Re-Birth of Family Law Arbitration" to the ADR Institute of Ontario, and published an article titled "Pre-Nups: How to Make'em and How to Break'em" in the Canadian Family Law Quarterly. On April 11, Lorne presented a paper titled "The CBV as Arbitrator" to the Canadian Institute of Chartered Business Valuators.

Jodi Kovitz's article, "Family Law

Arbitration: A New Regime," appeared in the January issue of The Family Way: CBA National Family Law Section newsletter.

## Torkin Manes Golf Tournament

Our 9th Annual Torkin Manes Charity

Golf Tournament to benefit the

SickKids Foundation will be held at

Silver Lakes Golf and Country Club on

Thursday, June 14.

For more information, please call Michelle Thompson at 416 643 8816.

## Baycrest ProAm Hockey

Daniel Melamed, Irv Kleiner, Matthew Tevlin, Allan Bronstein and Leonard Rodness participated in the Baycrest Pro-Am Hockey Tournament in support of Alzheimers research on April 27 and 28. Each team drafted and played with an NHL Alumnus. "The Ice Ages" team was formed by our frozen five, along with friends of Torkin Manes, and finished among the top six fundraising teams in the tournament, raising about \$84,000 to help Baycrest in its fight against Alzheimer's. The Ice Ages had the privilege of playing with Hockey Hall of Famer Dale Hawerchuk, who played with the Winnipeg Jets, Buffalo Sabres, St. Louis Blues and Philadelphia Flyers.

Thanks to all who supported this worthwhile cause.

*Focus* is published regularly by Torkin Manes Cohen Arbus LLP, Barristers & Solicitors. The contents are of a general nature and are not intended to be a full and complete analysis of the topics. Before applying the concepts discussed in *Focus*, it is imperative that you consult your legal advisor.

If you would like to receive *Focus* by e-mail, please visit [www.torkinmanes.com](http://www.torkinmanes.com), or call Michelle Thompson at 416 643 8816, or e-mail [mthompson@torkinmanes.com](mailto:mthompson@torkinmanes.com).

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