COURT OF APPEAL FOR ONTARIO

CITATION: Fairfield Sentry Limited v. PricewaterhouseCoopers LLP, 2018 ONCA 696
DATE: 20180824
DOCKET: C64006

Benotto, Brown and Miller JJ.A.

BETWEEN

Fairfield Sentry Limited, Fairfield Sigma Limited, Fairfield Lambda Limited and Kenneth Krys, as Liquidator for Fairfield Sentry Limited and Fairfield Sigma Limited and Fairfield Lambda Limited

Plaintiffs (Appellants)

and

PricewaterhouseCoopers LLP and Stephen Wall

Defendants (Respondents)

Peter F.C. Howard, Patrick O'Kelly and Aaron L. Kreaden, for the appellants

Gerald L.R. Ranking, Sarah J. Armstrong and Kimberly Potter, for the respondents

Heard: April 19, 2018

On appeal from the order of Justice Frank Newbould of the Superior Court of Justice, dated June 14, 2017, with reasons reported at 2017 ONSC 3447, 48 C.B.R. (6th) 209.

BROWN J.A.:

I. OVERVIEW

[1] This appeal concerns an auditor's liability action that arose out of the "Ponzi" scheme orchestrated by Bernard L. Madoff through his company, Bernard L. Madoff Investment Securities LLC ("BLMIS"). Investors who deposited funds with BLMIS thought their money was being invested in securities or other assets. It was not. Madoff's scheme was a fraud, which ran for some 20 years. It was only revealed on December 11, 2008 by Mr. Madoff's own confession.

[2] The appellants, Fairfield Sentry Limited ("Sentry"), Fairfield Sigma Limited ("Sigma"), and Fairfield Lambda Limited ("Lambda") (collectively, the "Funds"), invested in BLMIS. Sentry invested directly. Sigma and Lambda were "feeder funds", indirectly investing in BLMIS through Sentry. The Funds were incorporated in the British Virgin Islands ("BVI").

[3] PricewaterhouseCoopers LLP audited the Funds' financial statements for the years ending December 31, 2006 and December 31, 2007.

[4] The Funds are in liquidation. By their BVI court-appointed Liquidators (the "Liquidators"), they have brought this action seeking damages from PricewaterhouseCoopers LLP and one of its partners, Stephen Wall (collectively "PwC"), asserting that PwC breached its contract and/or was negligent in performing the audits of the Funds' financial statements for those two years.

[5] Madoff's fraud was revealed publically on December 11, 2008. Shortly thereafter, BLIMIS was put into liquidation under the United States *Securities Investor Protection Act of 1970,* 15 U.S.C. § 78aaa-78lll (the "SIPA"). A court appointed Mr. Irving Picard (the "SIPA Trustee") as trustee for the SIPA liquidation.

[6] The Liquidators allege PwC should have uncovered Madoff's Ponzi scheme no later than April 24, 2007, when it delivered the Funds' audited 2006 financial statements. Because PwC did not do so, the Funds remained invested in BLMIS, as a result of which they contend they suffered damages of approximately $2.5 billion.

[7] PwC moved for summary judgment dismissing the action on the basis that the Funds had not suffered any damages. For purposes of the motion, liability was assumed. The only issue was whether there was a genuine issue regarding damages that required a trial.

[8] The motion judge granted summary judgment and dismissed the action. He applied the approach to calculating damages set out by this court in *Livent Inc. v. Deloitte & Touche*, 2016 ONCA 11, 128 O.R. (3d) 225; appeal allowed in part, 2017 SCC 63. He accepted the evidence of the damages expert tendered by PwC, Dr. M. Laurentius Marais. Applying the *Livent* methodology to that and other evidence, the motion judge concluded that the Funds had not suffered any damages and there was no genuine issue regarding damages that required a trial.

[9] The Liquidators submit the motion judge erred in arriving at that conclusion. They advance five grounds of appeal, which involve findings made by the motion judge either in respect of questions of fact or mixed fact and law. Four of the grounds of appeal concern findings the motion judge made about certain elements of his *Livent* damages calculation. The other ground of appeal contends the motion judge erred in drawing adverse inferences against the Funds on certain issues.

[10] The Liquidators argue the motion judge made palpable and overriding errors in respect of each ground of appeal. They contend that if they succeed on any one of the four grounds of appeal concerning the calculation of damages, then a genuine issue requiring a trial on damages arises, the order of the motion judge should be set aside, and the action should proceed to trial.

[11] For the reasons that follow, I would dismiss the appeal.

[12] I will consider first: (i) the standard of review; (ii) the creation of the evidentiary record below; and (iii) whether the motion judge erred by improperly drawing an adverse inference against the Funds. I will then deal with each of the four additional grounds of appeal concerning the calculation of damages under the *Livent* methodology: (i) the motion judge's treatment of the Funds' withdrawal of $1.03 billion from BLMIS; (ii) his treatment of the non-forbearance amounts of judgments consented to by the Funds in favour of the SIPA Trustee; (iii) his treatment of "actual and constructive fraudulent conveyance liabilities" and

"investors' liabilities"; and (iv) his description, in para. 65 of his reasons, of the "investor liabilities" line item as a "net increase in liabilities."

II. THE STANDARD OF REVIEW

[13] Absent an error of law, the exercise of powers under r. 20 of the *Rules of Civil Procedure* attracts deference. The motion judge's determination, based on the exercise of his fact-finding powers under r. 20.04(2.1), as to whether there is a genuine issue requiring a trial involves a question of mixed fact and law. Where there is no extricable error in principle, findings of mixed fact and law should not be overturned absent palpable and overriding error: *Hryniak v. Mauldin*, 2014 SCC 7, [2014] 1 S.C.R. 87, at para. 81. Palpable and overriding error also is the standard of review for findings or inferences of fact: *Benhaim v. St-Germain*, 2016 SCC 48, [2016] 2 S.C.R. 352, at para. 36.

[14] A highly deferential standard of review, palpable and overriding error means an error that is obvious and goes to the very core of the outcome of the case. In the language of the metaphors approved by the Supreme Court of Canada in *Benhaim*, a palpable and overriding error is "in the nature not of a needle in the haystack, but of a beam in the eye"; it does not involve pulling at leaves and branches, leaving the tree standing, instead "the entire tree must fall": at paras. 38-39.

III. THE EVIDENTIARY RECORD

[15] By the time of the hearing of the summary judgment motion, the parties were proceeding on the basis that the method for assessing whether the Funds suffered any damages by reason of PwC's alleged negligence was that set out in the decision of this court in *Livent*, at paras. 62 and 63: Loss (L) = Actual Liquidation Deficit (ALD) – Estimated Liquidation Deficit (ELD) or, L = ALD – ELD.

[16] In the present case, the date for calculating the Actual Liquidation Deficit would be December 11, 2008, when Madoff's fraud was revealed. The date for the Estimated Liquidation Deficit would be April 24, 2007, the date PwC delivered its audit for the Funds' 2006 financial year.

[17] Both parties adduced evidence on the issue of the losses allegedly sustained by the Funds. It is important to understand the substance of that evidence as it unfolded through the parties' various filings.

PwC's initial evidence filing: November 2015

[18] In its notice of motion for summary judgment, PwC alleged the Funds did not suffer any damage as they had gained and recovered a net value of $1.03 billion from BLMIS between the EDL and ADL dates.

[19] By way of supporting evidence, PwC filed an affidavit from Stephen Wall, a PwC partner, as well as one from Dr. Marais, whom the motion judge accepted as qualified to provide expert evidence on the determination of damages.

[20] In his first affidavit, Dr. Marais opined that the Funds had not suffered any damages because they withdrew more from BLMIS between the ELD date and ALD date than they had put in.

[21] I would note that the Funds did not appeal the motion judge's acceptance of Dr. Marais as an expert witness. The notice of appeal did state that the motion judge erred by "uncritically accepting the evidence of the Respondent's expert, Dr. Marais, who was not qualified to provide his opinion to the Court." However, apart from the occasional comment regarding Dr. Marais' lack of accounting credentials, the Funds did not otherwise canvass in written or oral argument the issue of the motion judge's acceptance of Dr. Marais as a qualified expert.

The Liquidators' responding evidence: April 2016

[22] In response, the Liquidators filed affidavits from: (i) Mr. Kenneth Krys, one of the two joint Liquidators for each fund; (ii) Mr. Ian Ratner, a business valuator; and (iii) Mr. Michael Pompeo, a New York attorney.

[23] Mr. Krys was not tendered as an expert witness. His affidavit contained, at para. 62, a chart showing a comparative balance sheet calculation of the Funds' net assets as of the ELD and ALD (the "Krys Chart"). He deposed that the difference between the amounts revealed a best estimate of the Funds' damages in the amount of $2.508 billion.

[24] Mr. Ratner was accepted as a valuation expert. As described by the motion judge, Mr. Ratner "did not provide any independent analysis of the damage claim but did opine that Mr. Krys has applied the appropriate approach and methodology to quantify damages." Mr. Ratner also was "critical of the approach to value used by Dr. Marais" in his first affidavit: at paras. 39-40.

[25] Finally, the Liquidators filed an affidavit from Mr. Pompeo, who provided expert opinion evidence on matters of United States insolvency law.

PwC's request for information

[26] In May 2016, PwC requested that the Liquidators produce the documents upon which Mr. Krys relied to calculate the assets, liabilities, redemptions, and SIPA claims set out in his affidavit.

[27] In his supplementary August 11, 2016 affidavit, Mr. Krys produced the requested information and updated some of the figures used in his initial calculation, including an updated Krys Chart. Mr. Krys revised his best estimate of the Funds' damages to $2.422 billion.

PwC's reply evidence: November 2016

[28] In reply, PwC filed a second affidavit from Dr. Marais. In it, Dr. Marais used the approach that Messrs. Krys and Ratner deposed was the proper one for calculating the Funds' damages. Dr. Marais started his analysis with the Krys Chart, as revised ("Marais Ex. C"), and then broke down the liabilities shown on

the Krys Chart into their constituent parts ("Marais Ex. D"), identified four pairs of offsetting asset and liability line items ("Marais Ex. E"), and then cancelled the offsetting pairs and explained why he would disallow other line items as unsupported ("Marais Ex. F"). Dr. Marais concluded that the Funds' liquidation deficit had decreased, not increased, between the ELD date and the ALD date, with the result the Funds had not suffered a loss.

[29] PwC also filed an affidavit from Mr. Robert Gerber, a retired United States Bankruptcy Judge, who opined on issues of U.S. insolvency law.

2017 evidence

[30] Mr. Krys was cross-examined on March 6, 2017. At the start of the cross-examination, the Liquidators tendered a revised chart prepared by Mr. Krys (hereafter "Krys Ex. 3"). The major change Krys Ex. 3 made to the initial Krys Chart was altering the basis for calculating the liability line item, "Madoff Investors." This change will be discussed below in the section dealing with the third ground of appeal concerning the judgments the Funds consented to in favour of the SIPA Trustee. In Krys Ex. 3, Mr. Krys revised his calculation of the Funds' loss to $2.577 billion.

[31] In response, about two weeks later PwC filed a second affidavit from Mr. Gerber in which he opined on U.S. legal issues raised by Krys Ex. 3.

[32] The Liquidators cross-examined Dr. Marais on March 28, 2017; they cross-examined Mr. Gerber on March 31, 2017.

[33] The Liquidators did not file any expert evidence to challenge Dr. Marais' critique of Mr. Krys' calculations. Nor did they file a further affidavit from Mr. Krys.

[34] As this chronology of the evidentiary filings discloses, the damages theory first advanced by PwC in its notice of motion quickly shifted to the use of the *Livent* methodology, as propounded by the Liquidators. In the result, the motion judge decided whether a genuine issue regarding damages requiring a trial existed by applying the *Livent* methodology to the comparative liquidation deficit framework advanced by Mr. Krys in his various charts, as broken down and critiqued by Dr. Marais, and supplemented by the legal opinions of Mr. Gerber.

IV. FIRST GROUND OF APPEAL: THE MOTION JUDGE MADE AN IMPROPER ADVERSE INFERENCE

[35] The Liquidators did not file evidence replying to the critiques of the Krys charts made by Dr. Marais and Mr. Gerber. The Liquidators submit the motion judge erred when considering the significance of the absence of such evidence. They contend the motion judge improperly drew an adverse inference against the Liquidators for not seeking the court's permission to file "sur-reply evidence", thereby failing to put their best foot forward on a summary judgment motion. According to the Liquidators, since the *Rules of Civil Procedure* did not permit them

to file evidence responding to the second affidavits of Dr. Marais and Mr. Gerber "as of right," it was inappropriate for the trial judge to hold their failure to do so against them. As well, the Liquidators contend the motion judge failed to consider whether additional evidence from them was necessary to address the issue on the motion. In their view, the record as it stood did not eliminate the possibility that the Liquidators could recover damages, so the motion judge could not grant summary judgment.

[36] I am not persuaded by these submissions.

[37] First, the motion judge's reasons disclose that he did not make any adverse finding of fact against the Liquidators by reason of the absence of evidence responding to the second affidavits of Dr. Marais and Mr. Gerber. At one point in his reasons the motion judge did observe that the Liquidators had not adduced adequate evidence explaining certain issues, such as the inclusion of phantom profits in calculating the Funds' liabilities to its investors: at paras. 80-82 and 85. He described that as a failure to put their best foot forward on those issues. The motion judge did not draw any adverse inference of fact against the Liquidators. He simply observed that certain arguments advanced by the Liquidators lacked evidentiary support.

[38] Second, the Liquidators have no basis to complain that as part of his analysis the motion judge took into account the absence of evidence, expert or

otherwise, responding to the critique by Dr. Marais of the Krys Chart or to Mr. Gerber's second affidavit. This was a Commercial List proceeding, case managed by the motion judge. Great flexibility is available in Commercial List proceedings to ensure the fairness of the ultimate hearing. If the Liquidators had wanted to file evidence responding to the detailed critique performed by Dr. Marais in his second affidavit or Mr. Gerber's evidence, notwithstanding that they had already conducted cross-examinations, all they had to do was ask the motion judge for leave: r. 39.02(2). In para. 36 of his reasons, the motion judge stated what his answer would have been to such a request:

> It is said on behalf of the Liquidators that they had no right to file further affidavits under the rules because they had cross-examined on affidavits filed by PwC. I do not accept that. In the Commercial List, the right to file further affidavit material after cross-examinations is routine and had the Liquidators sought that right, I would no doubt have granted it to them.

[39] Accordingly, I see no error in the motion judge's treatment of this issue nor any procedural unfairness to the Liquidators from the motion judge's conduct of the summary judgment motion. I would not give effect to this ground of appeal.

V. SECOND GROUND OF APPEAL: THE MOTION JUDGE'S TREATMENT OF THE $1.03 BILLION AT LINE 7.4 OF THE DECONSTRUCTED KRYS CHART

[40] The Liquidators submit the motion judge made a palpable and overriding error of fact by treating the Funds' net withdrawal of $1.03 billion from BLMIS between the ELD and ALD as a "benefit" to the Funds and then using that amount to eliminate the Funds' damages.

A. The evidence

[41] Assessing this ground of appeal requires an understanding of the multi-step approach the motion judge used when analyzing the evidence within the framework of the *Livent* methodology.

[42] In his first affidavit, Dr. Marais opined that the Funds had realized a net gain on their investments between the ELD and ALD because during that period of time the Funds withdrew $1.03 billion more from BLMIS than they had invested in BLMIS over the same period.

[43] Mr. Ratner criticized that methodology as inappropriate and incomplete because it failed to consider the losses related to all assets and liabilities of the Funds between April 2007 and December 2008. Instead, Dr. Marais improperly focused solely on the net change in investments and redemptions in BLMIS, which was only one component of the Funds' total assets and liabilities.

[44] Mr. Ratner stated that the appropriate methodology was that used by Mr. Krys, which compared the estimated liquidation deficit of the Funds on the ELD date with the actual liquidation deficit on the ALD date.

[45] In his second affidavit, Dr. Marais accepted and applied the methodology used by Mr. Krys. The motion judge dealt with the motion on the basis, without deciding, that the damages calculation methodology used by Mr. Krys was the appropriate one: at para. 40.

[46] The motion judge summarized his findings of fact on a chart contained at para. 86 of his reasons (the "Findings Chart"). That chart had its genesis in the Krys Chart: at para. 48. As the motion judge observed, Dr. Marais broke down the figures on the Krys Chart into their constituent components on Marais Ex. D. The motion judge stated: "[Dr. Marais] was not cross-examined on his breakdown and I accept it": at para. 66.

[47] Using the deconstructed Krys Chart, the motion judge then considered adjustments made by Dr. Marais to the Krys Chart, as set out in Marais Exs. E and F. The motion judge gave clear, detailed reasons why he preferred the evidence of Dr. Marais over that of Mr. Krys on many points. He accepted Dr. Marais' conclusion that, once proper adjustments were made to the Krys Chart, it showed the Funds were better off by some $857.5 million as between the ELD and ALD. The motion judge showed the mechanics of that analysis in his Findings Chart.

Accepting the accuracy of the figures displayed on the Findings Chart, the motion judge concluded that the Liquidators had not established any damages. As a result, there was no genuine issue regarding damages that required a trial.

B. Analysis

[48] The Liquidators submit the motion judge erred in his treatment of the $1.03 billion entry at line 7.4, column (e), on his Findings Chart, under the Funds' liabilities to its own investors: "BLMIS holdings: Sentry net equity." The motion judge took that amount into account in conducting his comparative liquidation deficit analysis. The Liquidators submit he erred in so doing. In their factum they characterize the error as a palpable and overriding error of fact; during oral argument, their counsel described it as an error of law. On either characterization, I am not persuaded the motion judge erred.

[49] It is clear from Marais Exs. C, D and E that line 7.4 traces its origins back to the single, aggregated line 7 – "Funds investors" - on the initial Krys Chart. In his first affidavit, Mr. Krys explained that the "Funds investors" line item estimated the Funds' liability to their own investors (not to third party investors in BLMIS). The figures he set out at the ELD and ALD dates showed the balance outstanding to investors in the Funds.

[50] As mentioned, Dr. Marais took the aggregated line 7 figures for "Funds investors" in the Krys Chart and, using the information provided by Mr. Krys in

response to PwC's request for production, broke them down into their constituent elements, including row 7.4. The motion judge specifically noted that Dr. Marais had accepted the entry at line 7.4 - "BLMIS holdings: Sentry net equity" - for a gain of $1.03 billion between the ELD and ALD: at para. 67.

[51] The Liquidators cross-examined Dr. Marais on his two affidavits. However, that cross-examination did not involve questioning Dr. Marais on how he had deconstructed the Krys Chart – specifically, line 7 of the liabilities, "Funds investors" – or how, as part of that deconstruction, he had arrived at the net figure of $1.03 billion shown on line 7.4 of Marais Ex. D. Nor was Dr. Marais cross-examined on how he ultimately treated the deconstructed $1.03 billion amount, in the light of other adjustments he made to the deconstructed Krys Chart, to arrive at his ultimate opinion that the Funds suffered no actual harm by reason of PwC's conduct. From the submissions made at the hearing of the appeal, it is clear that the absence of such cross-examination was a tactical decision made by the Liquidators.

[52] Further, the Liquidators produced Krys Ex. 3 - a revised chart comparing the Funds' balance sheets at the ELD and ALD dates - at the start of PwC's cross-examination of Mr. Krys, which was some three weeks before the Liquidators' cross-examination of Dr. Marais. Krys Ex. 3 did not employ the deconstructed line items used by Dr. Marais on Marais Ex. D. Instead, Mr. Krys continued to present the ELD and ALD figures on the aggregated basis used in his initial Krys Chart.

[53] Two comments follow from the Liquidators' reliance on Krys Ex. 3. First, the net change of approximately $172 million in line 7 "Investor's Liabilities" between the ELD and ALD shown on the initial Krys Chart – which Dr. Marais broke down into its constituent elements – was not removed by Mr. Krys in his Krys Ex. 3. This would suggest that Mr. Krys considered it appropriate to continue to include the embedded $1.03 billion line item 7.4 in the comparative liquidation deficit analysis. Second, at the start of Mr. Krys' cross-examination the Liquidators could have filed a revised Krys Chart that responded to or modified the line item break downs performed by Dr. Marais, including the $1.03 billion. They chose not to do so.

[54] The Liquidators did not file any evidence, from an expert or Mr. Krys, critiquing Dr. Marais' deconstruction of and adjustments to the Krys Chart. Nor did they file any reply evidence countering the opinion of Dr. Marais that, in effect, the application of the *Livent* comparative liquidation deficit methodology to the values shown in the various rows on the deconstructed Krys Chart did not give rise to a genuine issue about damages requiring a trial.

[55] In flagging this absence of evidence from the Liquidators, I am not suggesting that the Funds bore the ultimate burden of demonstrating the existence of a genuine damages issue requiring a trial. They did not. On a motion for summary judgment, the ultimate burden remains on the moving party to demonstrate that no genuine issue requiring a trial exists. However, on a motion for summary judgment a responding party runs significant litigation risk if it leaves

unchallenged key evidence of the moving party adduced to establish there is no genuine issue requiring a trial.

[56] Given the state of the record before him, I see no palpable and overriding error by the motion judge in including the $1.03 billion shown on line 7.4 of his Findings Chart in his comparative liquidation deficit analysis. The motion judge worked in a most transparent way with the evidentiary record placed before him by the parties. The starting point of his analysis on this issue was the evidence of the Liquidators, as then broken down by Dr. Marais in a manner that was not challenged by the Liquidators. Accordingly, his ultimate findings of fact, including the $1.03 billion at line 7.4, column (e), of his Findings Chart, were supported by the record and based on the comparative liquidation date framework for calculating damages advanced by the Liquidators in their evidence.

VI. THIRD GROUND OF APPEAL: THE MOTION JUDGE'S TREATMENT OF THE NON-FORBEARANCE JUDGMENT AMOUNTS

A. The issue stated

[57] The Liquidators submit the motion judge committed a palpable and overriding error in his treatment of the amounts set out in certain judgments the Funds consented to in favour of the SIPA Trustee.

[58] This ground of appeal brings into play two matters: (i) the key change made to the initial Krys Chart by the updated Krys Ex. 3 chart produced by the Liquidators

at the start of Mr. Krys' cross-examination; and (ii) the meaning and effect of the judgments granted by the Funds in favour of the SIPA Trustee as part of the May 9, 2011 Settlement Agreement reached between them (the "Settlement Agreement").

The major change contained in Krys Ex. 3

[59] In his initial Krys Chart, Mr. Krys included, at line 6, amounts for liabilities to "Madoff investors." In his first affidavit, Mr. Krys described that liability as the recognition of potential claims by other investors in BLMIS against the Funds, under U.S. and state insolvency and avoidance law, to recover redemption payments made by BLMIS to Sentry. The figures at line 6 represented Mr. Krys' estimate of what he described as the Funds' actual and constructive fraudulent conveyance liabilities to BLMIS investors for the six-year avoidance "claw back" periods prior to the ELD and ALD.

[60] In his second affidavit, Dr. Marais broke line 6 down into two sub-lines. The first, line 6.1, set out Mr. Krys' estimate of the liabilities of the two feeder funds, Sigma and Lambda, to the other investors in BLMIS. Dr. Marais opined that the inclusion of those amounts was a form of double-counting and he removed the amounts from his analysis.

[61] The second sub-line, line 6.2, set out the estimate by Mr. Krys of Sentry's potential liability to other BLMIS investors for redemptions Sentry received from

BLMIS during the avoidance "claw back" periods. Dr. Marais opined that those amounts should not be included in the analysis for two reasons. First, no such claim by another BLMIS investor had been documented notwithstanding that seven years had passed since the revelation of Madoff's fraud. Second, Dr. Marais understood from counsel that the "applicable statutes of limitations bar any such claim from being asserted now or in the future."

[62] In the result, Dr. Marais valued the Krys Chart's line 6 liability at zero for purposes of the *Livent* methodology.

[63] The first affidavit of Mr. Gerber, sworn around the same time as the second Dr. Marais affidavit, expressed opinions on matters of U.S. insolvency law and state avoidance law. In respect of the Krys Chart's line 6 liability of the Funds to other BLMIS investors, Mr. Gerber made two main points. First, he pointed out that no BLMIS investor actually had asserted any fraudulent conveyance claim against the Funds and the limitation period for such claims had passed. Second, he stated, at para. 103 of his first affidavit:

> [B]ack in December 2011, the SIPA Trustee assumed the necessary standing to assert Avoidance Action claims on behalf of the BLMIS estate. Those claims thereupon ceased to belong to individual BLMIS creditors, and individual BLMIS creditors thereupon lost standing to bring them. They still lack standing to bring them. At least unless and until a trustee abandons those claims to individual creditors, they belong only to the trustee's estate, and creditors lack the power and standing to assert them.

[64] Three months later Mr. Krys attended for cross-examination. As mentioned, just prior to the start of the cross-examination the Liquidators produced a revised Krys Chart, the Krys Ex. 3. The primary change made by Krys Ex. 3 was to the source for calculating the line 6 liability of the Funds to Madoff investors. Mr. Krys initially estimated the Funds' potential liability for actual and constructive fraudulent conveyance claims that Madoff investors could bring. However, in Krys Ex. 3 he discarded his estimate of potential claims and replaced it with the actual amounts of the judgments in favour of the SIPA Trustee to which the Funds had consented under the Settlement Agreement, to which I now turn.

The Settlement Agreement

[65] Under the May 9, 2011 Settlement Agreement between the Liquidators and the SIPA Trustee, the Liquidators paid the SIPA Trustee $70 million. In addition, the Liquidators consented to three judgments in favour of the SIPA Trustee, one against each of the Funds (collectively, the "Judgments"). The amounts of the Judgments were, in U.S. dollars: Sentry judgment - $3.054 billion; Sigma judgment - $752 million; Lambda judgment - $52.9 million. Although the SIPA Trustee agreed to forbear from collecting on a defined portion of the Sentry judgment, the Settlement Agreement resulted in non-forbearance amounts under the Judgments against each Fund.

[66] As long as the non-forbearance amounts of the Judgments remain unsatisfied, the Settlement Agreement requires the Liquidators to pay to the SIPA Trustee specified portions of recoveries made by the Liquidators against third parties in what the Agreement defines as "Redeemer Action Recoveries" and "Service Provider Claim Recoveries" (collectively, the "Judgment Reducing Recoveries"). For example, s. 4 of the Settlement Agreement provides that as long as the non-forbearance amounts of the Judgments have not been satisfied, the Liquidators shall pay the SIPA Trustee 15% of the Liquidators' net recoveries from the specified Redeemer Actions against third parties.

[67] The Settlement Agreement limits the right of the SIPA Trustee to enforce the Judgments against the Liquidators. The SIPA Trustee can only look to the Judgment Reducing Recoveries to reduce the non-forbearance amounts under the Judgments.

[68] Shortly after the cross-examination of Mr. Krys at which the Funds tendered Krys Ex. 3, PwC filed a second affidavit from Mr. Gerber. That affidavit focused on Krys Ex. 3, including the revised chart's reliance on the Judgments as the source for the line 6 liability of the Funds to Madoff Investors. Mr. Gerber expressed several opinions: (i) under the terms of the Settlement Agreement, the Judgments are not assignable, so only the SIPA Trustee can enforce them; (ii) the SIPA Trustee cannot get any distributions on account of the Judgments from the existing assets of the Funds but only from the agreed shared recoveries; (iii) the SIPA

Trustee cannot execute or sue on the Judgments except in accordance with their terms as defined by the Settlement Agreement; and (iv) the Judgments effectively provide the means for determining when the SIPA Trustee's entitlement to litigation recoveries under the sharing agreement will come to an end.

[69] Mr. Gerber summarized his opinion at para. 41 of his second affidavit, where he stated:

> Thus, with my knowledge of the U.S. bankruptcy law relating to the approval of settlements, and my ability to read an agreement, I cannot find the Judgments to be a basis for quantifying the liability of the Fairfield Funds to fellow BLMIS investors, or for providing a basis to collect over $3 billion from PwC.

[70] The Liquidators conducted a brief, 20-minute cross-examination of Mr. Gerber. They did not examine him on the opinions he expressed about the effect of the Settlement Agreement and Judgments. The Liquidators did not file evidence from an expert responding to or commenting on the opinions expressed by Mr. Gerber.

A. Analysis

[71] The Liquidators submit that the motion judge erred in eliminating the entire amount of the Judgments from the damages calculation. They argue in their factum that "[t]he Judgments did not form part of Marais' analysis," so the motion judge's "conclusion on this issue derives from his own interpretation of the Settlement

Agreement and accounting of these numbers." The Liquidators contend he erred on both matters.

[72] I do not accept this submission. I have described in the preceding section how the evidence on this issue unfolded and the state of the record before the motion judge. The motion judge followed the evidence and his finding was rooted in the evidence.

[73] The motion judge summarized the nature of the Funds' obligations arising under the Judgments in paras. 24 and 62 of his reasons:

> The judgments were no ordinary judgments. They were subject to the Settlement Agreement which provided that part of the judgment against Sentry was forborne and not to be collected. The remainder of that judgment and the judgments against Sigma and Lambda were to be paid from amounts collected by the SIPA Trustee from third parties against whom claims had been made. In exchange, Sentry was granted an allowed claim in the SIPA proceeding in the amount of $230 million.
>
> ...
>
> On a plain reading of the judgments and the Settlement Agreement, and as confirmed by Mr. Gerber, the judgments for the [non-]forbearance amount of the judgment against Sentry and the amounts of the judgments against Sigma and Lambda can only be satisfied from funds of third parties through the litigation to be pursued against those third parties. There can be no attempt to collect on those judgments from the Fairfield Funds or their Liquidators.

[74] In these portions of his reasons, I see no misapprehension by the motion judge about how the Funds were to satisfy the non-forbearance amounts of the

Judgments under the Settlement Agreement. His interpretation was grounded solidly in the language of the Settlement Agreement, Judgments, and evidence.

[75] As I understand their submission, the Liquidators' main quarrel is with what the motion judge wrote in the ensuing portion of para. 62 of his reasons:

> Thus I agree with PwC that Mr. Krys erred in including in liabilities of the Fairfield Funds any liability of the Fairfield Funds or their Liquidators to the SIPA Trustee or to customers of BLMIS. This applies to both the ELD as at April 24, 2007 and the ALD as of December 11, 2008.

[76] The Liquidators submit the motion judge erred in failing to treat the Funds' obligations under the Judgments as a liability for purposes of the comparative ELD and ALD analysis using the *Livent* methodology. First, the Liquidators repeat the submission they made to the motion judge that since the non-forbearance amounts of the Judgments in favour of the SIPA Trustee would be liabilities on the Funds' financial statements, those amounts should be treated as a "loss" for purposes of the *Livent* damages calculation, notwithstanding that the Settlement Agreement limits the obligation to repay those amounts to any recoveries the Funds obtains from third parties.

[77] Second, at para. 69 of their factum, the Liquidators argue that since the Settlement Agreement requires the Liquidators to pay the SIPA Trustee some portion of their net recoveries from third parties until the non-forbearance amounts of the Judgments are satisfied – for example, 15% of Redeemer Action Recoveries

– the Judgments constitute an actual liability of the Funds that must be included in the damage calculation.

[78] The motion judge gave clear reasons for rejecting the Liquidators' submission stating, at para. 63 of his reasons:

> In argument, [counsel for the Funds] asserted that the amount of the judgments is an item on the Fairfield Funds balance sheets and whether they can be paid or not is irrelevant. I disagree. First, there is no accounting evidence of any kind that a balance sheet at the relevant dates would include as a liability the judgments in this case in which no payments will come from the Fairfield Funds. It would make little sense for a balance sheet to list a liability that did not have to be paid by the particular Fund. Moreover, the formula in the Livent case was to take into account the actual losses (the Actual Liquidation Deficit or ALD) and the actual estimated loss, (the Estimated Liquidation Deficit or ELD), in that case involving losses on the sale of assets. In this case, the expert valuation expert for the Liquidators, Mr. Ratner, said the same thing, although in this case he said there are other things to be valued at the ALD and ELD dates, including the liabilities of the Fairfield Funds. What is to be garnered from the various calculations is the loss (or liquidation deficit) actually incurred and the loss (or liquidation deficit) estimated that would have actually occurred at the earlier date. A loss is not some paper entry that bears no reality to what actually occurred. [Emphasis added]

[79] I see no reversible error in that conclusion. The motion judge correctly stated the damages formula approved by this court in *Livent*. The extent to which liabilities such as the Funds' limited obligations under the non-forbearance Judgments would amount to an "actual loss" for the purpose of the *Livent* damages calculation

turned on the evidence. As the motion judge noted: "[T]here is no accounting evidence of any kind that a balance sheet at the relevant dates would include as a liability the judgments in this case in which no payments will come from the Fairfield Funds. It would make little sense for a balance sheet to list a liability that did not have to be paid by the particular Fund." That finding was firmly anchored in the evidentiary record, including the expert evidence of Mr. Gerber set out above in paras. 68-69.

[80] Accordingly, I would not give effect to this ground of appeal.

VII. FOURTH GROUND OF APPEAL: THE MOTION JUDGE'S TREATMENT OF OTHER LINE ITEMS

[81] The Liquidators next argue the motion judge failed to consider the effect of what they contend was the improper removal of two line items from the Krys Chart, as reproduced at para. 81 of their factum: "Actual and constructive fraudulent conveyance liabilities to Madoff Investors" and "Investors' Liabilities."

[82] I am not persuaded by this submission. It attempts to isolate certain line items without taking into account the motion judge's multi-step analysis of the EDL/ADL comparison, as described in the preceding sections.

[83] To repeat, the motion judge started his analysis with the appellants' evidence – the Krys Chart. The motion judge then accepted the deconstructed version of that chart adduced by Dr. Marais and explained, in considerable detail,

his findings in respect of various line items on that chart. The Liquidators did not file expert or other evidence responding to Dr. Marais' adjustment of the figures prepared by Mr. Krys or to Mr. Gerber's evidence about the Settlement Agreement and Judgments. It was open to the motion judge to prefer the evidence adduced by PwC, as long as he gave reasons for so doing that found support in the evidence. He did so. His Findings Chart was the result.

[84] Accordingly, I see no palpable and overriding error by the motion judge on this issue.

VIII. FIFTH GROUND OF APPEAL: THE MOTION JUDGE'S TREATMENT OF INVESTOR LIABILITIES

[85] Finally, the Liquidators advance a further ground of appeal in respect of the motion judge's treatment of "Investor Liabilities." They argue the motion judge made a palpable and overriding error in describing, at para. 65 of his reasons, the change between the EDL and ADL "Investor Liabilities" line item as a "net increase in liabilities."

[86] I do not accept this submission. Instead, I accept the submission made by PwC at para. 64 of its factum as the proper way in which to understand the description used by the motion judge in his reasons:

> While a reduction in the Fairfield Funds' liabilities is a benefit, rather than a loss, the error is actually only one of terminology … It is clear that the Motion Judge did not misapprehend the evidence and correctly removed from

> Mr. Krys' calculation non-existent liabilities (in respect of the Judgments), offsetting entries, entries that were double-counted and Fictitious Profits. Having done so, the Motion Judge correctly identified the "gain" in line 7.4 of [Marais] Exhibit F…

[87] Accordingly, I would not give effect to this ground of appeal.

IX. DISPOSITION

[88] For the reasons set out above, I would dismiss the appeal.

[89] Based on the agreement reached by the parties regarding the costs of the appeal, I would award PwC costs of $70,000, inclusive of disbursements and applicable taxes.

Released: AUG 24 2018

I agree M.L. Benotto J.A.

I agree J.A.