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# Remedies for Breach of Trust: An Overview

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# REMEDIES FOR BREACH OF TRUST: AN OVERVIEW

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## OVERVIEW

A trustee is to administer a trust in accordance with the terms of the trust and his or her obligations at law. A beneficiary has a corresponding right to have the trust administered in accordance with the terms of the trust and the trustee's legal duties. There are a wide range of remedies that come into play where trustees are found to have breached a duty, acted inappropriately, or the circumstances regarding the trustee and/or beneficiary have changed, whether purposefully or not. While the effect of these remedies may lead to compensation for the wronged beneficiary, or loss of compensation on the part of the trustee, these remedies can also have the effect of ensuring that the trustee, whether remunerated or not, will properly perform the duties of the office. [2]

While the remedies for a breach of trust are varied, this paper will primarily concentrate on two types of remedies, namely, personal remedies against a trustee and proprietary remedies.

## REMEDIES

Where trustees fail to live up to the standard of conduct required of them or otherwise fail to carry out their trust duties, beneficiaries may have a right of action against the trustees for breach

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[2] Mark Gillen and Faye Woodman, *The Law of Trusts, A Contextual Approach.* 2nd ed. (Toronto: Emond Montgomery Publications Limited, 2008) at 593.

of trust.[3] It might not matter whether the trustee intended to breach their trust duties.[4] The trust remedies available to a beneficiary in the circumstances of a loss in the trust might be restitutionary in character.[5] However, remedies for breach of trust may also be available to a beneficiary even where there is no actual loss.

The following is a list of remedies that a beneficiary may consider. This list is not intended to be exhaustive. The focus of the paper remains, however, on remedies available to beneficiaries for recovery against the trustee personally and remedies aimed at the trust property:

- Declaratory judgments;
- Injunctions[6];
- The setting aside of transactions (unless the purchaser is a *bona fide* purchaser for value without notice of the trust property in question);
- The removal and/or replacement of trustees;
- The exercise of trust administration by the Court (although this is quite rare);
- Obtaining the opinion, advice and direction of the Court;
- Opposing the grant of specific performance where trustees enter into contracts in breach of trust (sought by either the trustee or the purchaser);

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[3] *Ibid.*

[4] See *RSG Mechanical Inc. v. ABCO Construction Inc.* (2000), 5 C.L.R. (3d) 294 (Ont. Sup.Ct.) at para. 66; However, note that where a trustee has been honest and diligent, the Courts are often loath to find that a breach has occurred at all. For this point, see D.W.M. Waters, Q.C., Mark R. Gillen and Lionel D. Smith, *Waters' Law of Trusts in Canada*. 3rd ed. (Toronto: Thomson Canada Limited, 2005) at 1208.

[5] *Supra* note 2 at 593-4; See also *Fales v. Canada Permanent Trust Co.*,[1977] 2 S.C.R. 302 at 320 (S.C.C.).

[6] An injunction is a remedy that is available to a beneficiary to prevent the commission of a breach of trust or to compel a trustee to perform duties owed to the beneficiary.

- The ordering of the trustee's accounts in respect of the administration of the trust;

- The removal of a trustee's compensation (either in whole or in part);

- Obtaining an award of costs against a trustee (in some instances, this may include having one trustee be responsible for his or her own costs and the costs of another trustee);

- The waiver or reduction of a trustee's right to indemnity for personal expenses;

- The removal of a beneficiary's interest under a trust (where the beneficiary instigates a breach of trust, requests such a breach or acquiesces to the breach by a trustee);

- Equitable compensation; and

- Disgorgement of profits and accounting. [7]

**THE NATURE OF TRUSTEE LIABILITY**

By way of overview, a breach of trust can occur when the trustee's duty to act within the terms of his or her obligations is not fulfilled.

Where there is more than one trustee to a trust, the trustees are jointly and severally liable to the trust beneficiaries for losses stemming from a breach of trust.[8] The principle of joint and several liability means that unless a trustee is excused from a breach, all trustees are equally liable for the loss incurred, thereby enabling a beneficiary to seek recovery from any, or all of them. This liability may be broken down into two components, namely, (1) the individual trustee's liability

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[7] *Supra* note 2 at 695. See Rule 74.15-74.18 of the *Rules of Civil Procedure*. See also Craig Vander Zee, "Changing Trustees: Voluntary, Involuntary Changes and Negotiating the Removal and Replacement of a Trustee", Trusts, Trustees, Trusteeships III, (Toronto: Ontario Bar Association, Continuing Legal Education Program, September 24, 2007).

[8] *Ibid.* at 594.

for his or her own part in the loss; and (2) the individual trustee's liability for any loss incurred as a result of the actions of any other trustee.[9]

## PERSONAL AND PROPRIETARY REMEDIES

Personal remedies and proprietary remedies are aimed at compensating the beneficiary for loss to the trust. While proprietary remedies are focussed on the trust property, personal remedies are those that are enforceable against the trustee personally or *in personam*.[10] As such, personal remedies are often used when trust property is no longer in the possession of the trustee or where the value of the trust property is insufficient to satisfy a beneficiary's claim. In such cases, beneficiaries may be able to recoup losses caused by the trustee's breach of duty through actions for compensation.

In some situations, however, personal remedies are ineffective in providing relief for a breach of trust. Where a trustee has limited finances or is insolvent, a personal remedy may be of little use. In those cases, the recourse may be to trust property – the aim being to recover either the lost trust property, its converted form, or a proportionate amount of a larger fund into which the trust property or its converted form has been deposited.[11] Proprietary remedies are also advantageous over personal remedies where a trustee has a defence to a personal action or is relieved from responsibility for breach of duty such as by operation of statute.[12] Another significant advantage to a proprietary remedy over a personal remedy is the fact that proprietary rights take

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[9] *Ibid.*
[10] *Ibid.*
[11] *Supra* note 2 at 595.
[12] *Ibid.*; To consider the protection that a trustee has against liability, see Craig Vander Zee, "Trustee Mistakes", Ontario Bar Association Annual Institute, (Toronto: Ontario Bar Association Continuing Legal Education Program, October 1, 2009).

priority over the claims of creditors, whereas the personal claim ranks behind the claims of creditors.[13]

The choice between whether to pursue a personal or proprietary remedy may be dependent on the nature of the breach of trust. In circumstances where both remedies are available, a beneficiary may be able pursue whichever remedy will yield the most advantageous result on the facts of the matter.

### (a) Personal Remedies

Personal remedies available for a breach of trust include compensation for loss awarded against a trustee in favour of a beneficiary, also known as equitable compensation. The beneficiary may be entitled to enforce this type of award against a trustee personally.[14] In addition to an award of equitable compensation, a beneficiary may be able to recover profits earned by a trustee during unauthorized dealings with trust property through actions for an accounting. A beneficiary needs to consider the appropriate remedy based on the facts of the matter and the nature of the breach.

#### *(i) Equitable Compensation*

The aim of equitable compensation is restitution. This remedy seeks to repair and restore the person wronged to his or her position *status quo ante* the infringement by the fiduciary, which caused the loss. This remedy attempts to measure the plaintiff's loss, not disgorge the defendant's gain. "Equitable compensation is to be distinguished from equitable damages and other forms of monetary relief available in equity. Other equitable monetary relief, such as an accounting of profits or the restoration of specific trust property under a constructive trust have

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[13] *Supra* note 2 at 595.
[14] *Supra* note 2 at 594.

as the main goal the disgorgement of any unauthorized profit that the fiduciary may have made from the breach of fiduciary duty. Equitable compensation, on the other hand, seeks to compensate the plaintiff for his or her actual losses and therefore may mirror the approach for the assessment of common law damages. In addition, these damages are given in lieu of or in addition to either an injunction or a specific performance decree."[15]

"A fiduciary is required to not secure a personal profit from the position (the profit rule) and to not allow a conflict between the interests of the person to whom the fiduciary duty is owed and himself or herself (the conflict rule). If the fiduciary breaches these obligations, the usual remedies are the constructive trust and an accounting of profits, as referenced above."[16] However, there are some breaches of duty that will amount to a breach of fiduciary duty and yet an essential element of a trust does not exist. While traditional trust remedies are appropriate where the relationship is trust or trust like, these remedies do not readily fit the types of activities that are now being held to raise a fiduciary duty.[17]

Two of the decisions of the Court that have fleshed out the law on equitable compensation are *Canson Enterprises Ltd. v. Boughton & Co.*[18] and *Hodgkinson v. Simms.*[19]

***<u>Canson Enterprises Ltd. v. Boughton & Co.</u>***

The decision in *Canson, supra* deals with the scope of equitable compensation and the impact of remoteness of damages issues. In *Canson, supra*, the Supreme Court of Canada considered the extent to which a person who has suffered a loss from a breach of a fiduciary duty may recover

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[15] *Supra* note 2 at 597.
[16] *Ibid.* at 596.
[17] *Ibid.*
[18] [1991] 3 S.C.R. 534 (S.C.C.).
[19] [1994] 3 S.C.R. 377; (1995), 117 D.L.R. (4th) 161 (S.C.C.).

for that loss from the person who has committed the breach. Specifically, the case considered the extent of the liability of a solicitor who, in handling a real estate transaction, failed to disclose to the purchasers a secret profit made by a third party.

In *Canson, supra*, the purchasers agreed to purchase a piece of property from a seller and to develop it. Unknown to the purchaser, but known to respondent A, respondent B was involved in a second agreement pursuant to which respondent B received a profit on the sale because the property was being flipped. The evidence was that the purchaser would not have bought the property had it known of the second agreement.

The alleged breach of fiduciary duty arose out of the fact that W, a solicitor, acted for the purchasers in the preparation of the conveyance and joint venture agreement. W also acted for the party that respondent B entered into the second agreement with. As a result of this dual retainer, W knew about the secret profit. W did not disclose the secret profit to the purchasers. W delivered two statements of adjustments, one to the purchasers that did not disclose the secret profit, and another, undisclosed to the purchasers, that did.

In addition, this case was complicated by the fact that following the transaction, the purchasers proceeded with a warehouse development on the property, but suffered substantial losses when piles supporting the warehouse began to sink, causing extensive damage to the building. The purchasers brought an action against the soil engineers and a pile-driving company retained by them for the damage to the warehouse. While that action resulted in judgments against both defendants for negligence and breach of contract, the purchasers were unable to execute fully upon the judgments.

As a result, the purchasers then commenced an action against W and his law firm for the amount of the shortfall, alleging that the failure to disclose the secret profits was actionable as deceit or breach of fiduciary duty. The issue before the Court was whether the solicitor was responsible only for losses directly flowing from the breach of duty itself, or whether the solicitor was also liable for loss caused by an intervening act unrelated to that breach.[20]

At first instance, the trial judge found that the solicitor, W, was not liable in deceit, but liable for breach of fiduciary duty. However, the trial judge, Macdonell J. of the British Columbia Supreme Court, decided that compensatory damages should be awarded on the same basis as in an action for deceit. The measure of damages was the value of the secret profit, not the whole loss.

The decision of Macdonell J. was upheld by the British Columbia Court of Appeal. The Court of Appeal found that a fiduciary who mishandles trust property and causes a loss is liable in damages to be calculated by analogy to trust law. However, the Court held that the rule is limited to trust-like situations – that is, situations where the fiduciary holds property beneficially for another – and that the rule did not apply to a solicitor who was not holding property for the purchasers.

Lambert J. agreed with the reasons of Hutcheon J. (both speaking for the Court of Appeal), but gave reasons of his own. Lambert J. emphasized that the remedy for breach of fiduciary duty cannot be established on the basis of a body of rigid rules and that it is not possible to determine the appropriate remedy by defining the wrong simply as a breach of fiduciary duty. In his view,

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[20] *Supra* note 19 at para. 32.

the nature of wrong and the nature of the loss, not the nature of the cause of action, should dictate the scope of the remedy.

The purchasers appealed to the Supreme Court of Canada on the ground that compensation for breach of the fiduciary duty should be calculated on the same footing as for a breach of trust. According to the appellants purchasers, the task before the Supreme Court of Canada was the determination of the proper measure of restitution for breach of fiduciary duty in the present case. The Court had a choice between considering the principles applicable to breach of contract, negligence, or deceit. If the action was one founded on breach of contract, it would be necessary to consider whether the damages suffered were within the reasonable contemplation of the parties. If the action was founded in negligence, it would be proper to apply principles of remoteness, foreseeability and intervening cause. If the action was one for deceit, the defendant would arguably be liable not only for foreseeable, but unforeseeable damages flowing from the deceit, stopping, however, where the chain of causation was broken.

However, the appellants noted that if the action were brought on any of these bases, then, they could not recover for the substantial damages that arose from the actions of the engineering and the pile driving company. As such, the appellants argued that where such equitable compensation for breach of a fiduciary duty, as distinct from common laws damages, was sought, concepts of remoteness, intervening cause and foreseeability had no relevance. Instead, the appellants submitted that a court of equity in exercising its jurisdiction to compensate for loss suffered by a plaintiff as a result of a breach of a fiduciary relation is engaged in a process of restitution. The Court should therefore seek to put the appellants in as good a position as they would have been had the breach not occurred.

The essence of the respondents' argument was that the Court of Appeal was correct in holding that law and equity are now fused. The result, they argued, would therefore be that the common law remedy of damages, as limited by the principles of remoteness and causation, was also available for the equitable claim of breach of fiduciary duty. The respondents asserted that the appellants were attempting to recover losses which were not recoverable in contract or tort (because of remoteness) "under the cloak of a claim for restitution." They argued that the law of restitution had no application to the issues on the appeal. According to the respondents, restitution in equity, or at common law is concerned with circumstances where one party has been unjustly enriched at the expense of another. The equitable form of restitution is concerned with assets and profits, not with losses. As such, the Court should be wary of attempting to clothe all fiduciaries with the mantle of a trustee.

The respondents also argued that where no property had passed between the fiduciary and the beneficiary, the principles of liability for breach of trust would be of little assistance. Damages are a monetary payment awarded for the invasion of a right at common law. Equity is, they argued, aimed at restoring a person to whom a duty was owed to the position in which he or she would have been had the duty not been breached. This it did through a variety of remedies, including compensation.

In the result, the Supreme Court of Canada dismissed the appeal. Speaking for the majority, La Forest J. concluded:

> We have been given no case where the principles applicable to trusts have been applied to a breach of a fiduciary duty of the type in question here, and for reasons already given, I see no reason why they should be transposed here. The harshness of the result is reason alone, but apart from this, I do not think that the claim for the harm resulting from the actions of third parties can fairly be looked upon as falling within what is encompassed in restoration

> for the harm suffered from the breach. That is the view taken by all the Canadian courts that have dealt with the issue…
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> [That the] two streams of common law and equity have now mingled and interact are abundantly evident in this area. That is as it should be because in this particular area law and equity have for long been on the same course and whether one follows the way of equity through a flexible use of the relatively undeveloped remedy of compensation, or the common law's more developed approach to damages is of no great moment. Where "the measure of duty is the same", the same rule should apply… Only when there are different policy objectives should equity engage in its well-known flexibility …to achieve a different and fairer result…
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> …
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> Where a situation requires different policy objectives, then the remedy may be found in the system that appears more appropriate. This will often be equity. Its flexible remedies such as constructive trusts, account, tracing and compensation must continue to be moulded to meet the requirements of fairness and justice in specific situations. Nor should this process be confined to pre-existing situations. Lord Diplock has reminded us that the regime of conjoint application of law and equity introduced by the Judicature Act must not be seen as bringing to a halt the process of development of substantive law in both great systems of judicially created law.
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> But, as these cases underline, equity cannot be rigidly applied. Its doctrines must be attuned to different circumstances. Quite obviously not all fiduciary obligations are the same. It would be wholly inappropriate to interpret equitable doctrines so technically as to displace common law rules that achieve substantial justice in areas of common concern, thereby leading to harsh and inequitable results. I wholeheartedly reject the notion advanced by the appellants that the Court of Appeal fell "into error because of a misplaced [page589] concern with concepts of common sense and reasonableness". I would have thought these concerns were central to both common law and equity.[21]

As such, the Court found that damages equivalent to those for deceit were sufficient to compensate the purchasers.

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[21] *Supra* note 19 at paras. 76, 84, 86-87.

***Hodgkinson v. Simms***

A similar issue came before the Supreme Court of Canada a few years later in *Hodgkinson, supra.* In that case, the appellant H, a stock broker who was inexperienced in tax planning, hired S, an accountant, to provide him with advice. H relied heavily on the advice that he received from S, a reliance that was fostered by S. S advised H to buy four income tax sheltered properties. H lost heavily when the value of the four properties fell during a decline in the real estate market.

This was not a case of fraud or deceit because H did not overpay on the investments. The source of S's action lay in the fact that S was acting for the developers of the four properties during the relevant time when each of the properties were structured. S did not disclose this H. The evidence before the Court was that H would not have invested in the properties had he known the true nature of the relationship between S and the developers of the properties.

H brought an action for breach of fiduciary duty, breach of contract and negligence to recover all his losses on the four investments. The claim in negligence was dismissed at trial and was not appealed. However, the Court at first instance allowed the action for breach of fiduciary duty and breach of contract and awarded H damages on both heads. Prowse J., the trial judge found that the quantum of damages ought to be the same under either claim, namely the return of capital (adjusted to take into consideration the tax benefits received as a result of the investments), plus all consequential losses, including legal and accounting fees.

The British Columbia Court of Appeal upheld Prowse J. on the breach of contract issue, but reversed the decision on the issue of fiduciary duties and varied the damage award, setting damages at an amount equal to the fees received by S from the developers on account of the four properties. The Court of Appeal found that this was a case of material non-disclosure in which the appellant alleged breach of fiduciary duty and breach of contract against the respondent in the performance of a contract for investment advice.

On appeal, the Supreme Court of Canada again affirmed the decision of Prowse J. La Forest J., speaking for the majority, found that "the trial judge assessed damages flowing from both breach of fiduciary duty and breach of contract… I cannot find fault with the trial judge's disposition of the damages question." [22]

La Forest J. also concluded that "[i]t is well established that the proper approach to damages for breach of a fiduciary duty is restitutionary. On this approach, the appellant is entitled to be put in as good a position as he would have been in had the breach not occurred. On the facts here, this means that the appellant is entitled to be restored to the position that he was in before the transaction. The trial judge adopted this restitutionary approach and fixed damages at an amount equal to the return of capital, as well as all consequential losses, minus the amount the appellant saved on income tax due to the investments." [23]

La Forest J. added:

> Contrary to the respondent's submission, this result is not affected by the ratio of this Court's decision in Canson Enterprises, supra. Canson held that a court exercising equitable jurisdiction is not precluded from considering the principles of remoteness, causation, and intervening act where necessary to reach a just and fair result."[24]

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[22] *Supra* note 20 at para. 71.
[23] *Ibid.* at para. 73.
[24] *Supra* note 20 at para. 80.

La Forest J. found that *Canson, supra* did not signal a retreat from the principle of restitution. Rather, *Canson, supra* ought to be understood to stand for the fact that a breach of fiduciary duty can take many forms and as such a variety of remedial considerations may be appropriate.[25]

According to La Forest J.:

> Put another way, equity is not so rigid as to be susceptible to being used as a vehicle for punishing defendants with harsh damage awards out of all proportion to their actual behaviour. On the contrary, where the common law has developed a measured and just principle in response to a particular kind of wrong, equity is flexible enough to borrow from the common law. As I noted in Canson, at pp. 587-88, this approach is in accordance with the fusion of law and equity that occurred near the turn of the century under the auspices of the old Judicature Acts; see also M. (K.) v. M. (H.), supra, at p. 61. Thus, properly understood Canson stands for the proposition that courts should strive to treat similar wrongs similarly, regardless of the particular cause or causes of action that may have been pleaded. As I stated in Canson, at p. 581:
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> . . . barring different policy considerations underlying one action or the other, I see no reason why the same basic claim, whether framed in terms of a common law action or an equitable remedy, should give rise to different levels of redress.[26]

### *(ii) Accounting for Profits*

The remedy of accounting for profits is based on the principle that the trustees should not put themselves in a conflict of interest so that they will benefit from their positions as trustees. The accounting remedy may give rise to a remedial constructive trust in which the trustee holds the profits for the beneficiary on the basis of unjust enrichment or, alternatively, a simple order to account. Where trustees appropriate the means of acquiring a benefit, whether it is information or a business opportunity that rightfully belongs to the trust, the trust will normally suffer a loss.

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[25] *Ibid.*
[26] *Supra* note 20 at paras. 80-81.

However, the accounting remedy is not only restitutionary in nature. Sometimes a trustee may have to account for profits even if the trust could not have made the profit itself.[27]

Examples of the remedy of accounting for profits are found in the decisions in *MacMillan Bloedel Ltd. v. Binstead*[28] and *Air Canada v. M&L Travel Ltd.*[29]

***<u>MacMillan Bloedel Ltd. v. Binstead</u>***

On the facts of *MacMillan, supra*, a corporation, sought recovery of secret profits allegedly made by a senior employee and for an accounting. The plaintiff corporation operated a business of dealing in forest products and sold surplus logs through its marketing department. The defendant, B, was employed as the head of the department. Unknown to the plaintiff, B held a one-third interest in C. Corp., a company that was the main purchaser of the plaintiff corporation's surplus logs. There was no allegation whatsoever that C. Corp. had paid less than fair market value for the logs that it purchased, however, this action to recover profits was framed in three ways:

1. for money had and received,

2. for damages by reason of the tort based conduct of the defendants either in conspiracy, in fraud, or in inducing a breach of contract; and

3. for a declaration that certain of the defendants were fiduciaries or constructive trustees and for an accounting and delivery of the profit realized by these fiduciaries and trustees.

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[27] *Supra* note 2 at 623.
[28] (1983), 14 E.T.R. 269; [1983] B.C.J. No. 802 (B.C.S.C.).
[29] [1993] 3 S.C.R. 787 (S.C.C.).

The Court found that the shareholders of C. Corp., including B, were constructive trustees for the plaintiff and therefore accountable to the plaintiff. B was a fiduciary of the plaintiff by virtue of his position and was also accountable for the secret profits that he had made. The Court found that the fact that the plaintiff corporation had not suffered any damages, having sold to C. Corp. at fair market value, was immaterial. A fundamental breach of the fiduciary relationship had taken place.

The Court found that a trustee who has breached his duty and profited as a result is obligated to disgorge those profits regardless of whether there is a corresponding loss to the *cestui que trust*. Here the plaintiff had suffered little damage and was being placed in a better position than it would have been if not for the wrongful act of the defendants.[30] Applying these findings, the Court concluded that the plaintiff was entitled to recover $4,243,383.00 from the defendant as the net benefit received as a result of breach of fiduciary duty. As referenced above, the figure of $4,243,383.00 exceeded any award that could have been made either for money had and received or in tort.[31] However, in reaching this conclusion the Court noted that while a trustee must disgorge profit made from the trust assets or information, the trustee will be able to deduct reasonable expenses from the profits made.[32]

***<u>Air Canada v. M&L Travel Ltd.</u>***

This appeal concerned the personal liability of directors of a closely held corporation for breach of a trust by the corporation. The appellant was one of two directors of a small travel agency which contracted with the respondent airline to sell Air Canada tickets. The appellant borrowed money on a personal loan and invested it in a travel agency. The appellant paid the interest

[30] *Supra* note 34 at paras. 47, 48, 53 and 61.
[31] *Ibid.* at para. 71.
[32] *Ibid.* at para. 62.

owing on the loan from the agency's general banking account. The appellant later became one of the agency's two directors and its vice-president. Both directors had signing authority, but the agency's day to day business was left to the other director.[33]

The travel agency later contracted with Air Canada to sell the carrier's tickets. The funds collected from the sale of the tickets was to be held in trust by the travel agency for Air Canada and paid to Air Canada twice per month.[34] The travel agency also obtained an operating line of credit from a chartered bank. The monies advanced under the line of credit and interest thereon constituted a demand loan in favour of the Bank. Both directors personally guaranteed the loan and authorized the Bank to remove any monies owing on the loan at any time from the agency's general account. Although a trust account was set up by the managing director for the deposit of the airline funds held by the agency, that account was not used. The proceeds from the sale of the tickets were instead maintained in the agency's general operating bank account.[35]

A dispute arose between the directors when the managing director discovered cancelled cheques for the instalment payments on appellant's personal loan. It was the managing director's understanding that that appellant had agreed to cease making the payments for the time being and he stopped payment on the last instalment cheque. In turn, the appellant suspected the managing director of misappropriating funds and stopped payment on all cheques and withdrawals. At this time, the travel agency owed Air Canada $25,079.67 for ticket sales.[36]

As a result of the dispute, both directors, through their solicitors, negotiated for the purchase by one of the other's interest and both, during this time, made efforts to pay Air Canada. The

[33] *Supra* note 35 at paras. 2-3.
[34] *Ibid.* at para. 4.
[35] *Ibid.* at para. 5.
[36] *Ibid.* at paras. 7-8.

appellant testified that he opened a trust account, drew cheques for the monies that were still in the company account, withdrew the stop payment orders, and attempted to transfer the funds into the new trust account. The Bank refused to transfer the funds or to honour the cheques made out to Air Canada because of the conflicting instructions from the two directors. The Bank, after sending demand notices, withdrew the full amount owing it under the line of credit from the travel agency's general account.[37] Air Canada sued the travel agency and both directors personally for the money owed to it for ticket sales.

Air Canada’s claim against the travel agency was successful, but the claim against the two directors was dismissed.[38] The trial judge held that there was clearly a trust relationship between Air Canada and the travel agency, and that the travel agency had breached that trust by failing to protect Air Canada's interest. However, the more difficult question was whether the two directors were personally liable for breach of trust. According to the trial judge, the only way in which liability could be imposed on the individual defendants was if they had taken it upon themselves to possess and administer trust property for the beneficiary as if they were trustees. Each individual would then be a *trustee de son tort*.

However, the trial judge concluded:

> ... in this case there is no assumption, in my view, by the individual defendants to assume this trust. It is true, in signing the bank documents they gave the bank the right to do as they did but right up until the last moment they were trying each in their own way effectively or not, to protect the interest of Air Canada to keep their own interest alive by preserving the business of the travel agency... So, I see nothing mala fides in the actions of the individual defendants and I think they were inept in some of their

[37] *Ibid*. at paras. 7-8.
[38] *Ibid*. at para. 9.

> actions but, they were in no way, in my view, trustees that breached a trust so far as Air Canada is concerned. [39]

The trial judge dismissed the claim against the individual defendants.

Air Canada successfully appealed the judgment as it related to the two directors. The two questions on Air Canada's appeal were, first, was the relationship between the corporation and the respondent airline one of trust? Second, if so, was the appellant director personally liable for the breach of trust by the corporation? The legal issue raised by this second ground of appeal concerned the standards for the imposition of personal liability to be applied to strangers who participate in a breach of trust.

In concluding that the relationship between the directors and the airline was one of trust, the Court of Appeal relied on *Canadian Pacific Air Lines, Ltd. v. Canadian Imperial Bank of Commerce* (1987), 61 OR (2d) 233. Although the Court of Appeal's decision in that case was brief, the reasons of the trial judge, at p. 237, when into greater depth. The trial judge found:

> In order to constitute a trust, an arrangement must have three characteristics, known as the three certainties: certainty of intent, of subject-matter and of object. The agreement…is certain in its intent to create a trust. The subject-matter is to be the funds collected for ticket sales. The object, or beneficiary, of the trust is also clear; it is to be the airline. The necessary elements for the creation of a trust relationship are all present. I find that such a relationship did exist between CP and the two travel agencies.[40]

On appeal to the Supreme Court of Canada, Iacobucci J., speaking for the majority agreed that the analysis in *Canadian Pacific, supra* was applicable to the facts of *Air Canada, supra*. Iacobucci J. found that the intent of the agreement to create a trust was evident from the

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[39] *Ibid*. at paras. 10-11.
[40] *Ibid*. at para. 13.

following wording in the agreement: "All monies, less applicable commissions to which the Agent is entitled hereunder, collected by the Agent for air transportation (and for which the Agent has issued tickets or exchange orders) shall be the property of the Airline, and shall be held in trust by the Agent until satisfactorily accounted for to the airline."[41]

On this point, Iacobucci J. found that it was well established that the nature of the relationship between the parties is a matter of intention. In *Air Canada, supra*, the relationship of trust was further evidenced by the express prohibition restricting the use of the funds, and the supervision and control of the carrier over the financial dealings of the agency. Since there was clear evidence of intention to create a trust in the agreement between the agency and the respondent airline, the absence of a prohibition on the commingling of funds was not determinative, although it may be a factor to be taken into account, as it was here. Moreover, the Court found in *Air Canada, supra*, that the agency acted in accordance with that intention and set up trust accounts, which, although never used, confirm that the relationship was viewed by the directors as a trust relationship.[42]

With respect to the personal liability of the directors, Iacobucci J. noted that there are two general cases upon which a stranger to the trust can be held liable as a constructive trustee for breach of trust. First, although not directly relevant to the appeal in *Air Canada, supra*, strangers to the trust can be liable as *trustees de son tort*. Such persons, although not appointed trustees, "take on themselves to act as such and to possess and administer trust property." A *trustee de*

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[41] *Ibid*. at paras. 20 -23.
[42] *Ibid*. at paras. 24 and 30.

*son tort* will not be personally liable simply for the assumption of the duties of a trustee, but only if he or she commits a breach of trust while acting as a trustee.[43]

Second, strangers to the trust can also be personally liable for breach of trust if they knowingly participate in a breach of trust as either,

- one in receipt and chargeable with trust property (the "knowing receipt" category); or
- one who knowingly assisted in a dishonest and fraudulent design on the part of the trustees (the "knowing assistance" category).[44]

On the facts of *Air Canada, supra*, the directors did not personally control the trust funds. Iacobucci J. therefore concluded that the former category of "knowing receipt" of trust property was inapplicable because it required the stranger to the trust to have received trust property in his or her personal capacity, rather than as an agent of the trustees.[45] Instead, Iacobucci J. concluded that the only basis upon which the directors in *Air Canada, supra* could be held to be personally liable as constructive trustees was under the "knowing assistance" head of liability. The knowledge required for this type of liability is actual knowledge. However, as noted by the Court, recklessness or wilful blindness will also suffice.[46]

There is, however, a second line of Canadian authority, holding that a person who is the controlling or directing mind of a corporate trustee can be liable for an innocent or negligent

[43] *Ibid*. at paras. 32-33.
[44] *Ibid*. at paras. 34-35.
[45] *Ibid*. at para. 36.
[46] *Ibid*. at paras. 37-38.

breach of trust if the person knowingly assisted in the breach of trust. That is, in these cases, proof of fraud and dishonesty has not been required.[47]

In conclusion, Iacobucci J. found:

> It must be remembered that it is the nature of the breach of trust that is under consideration at this point in the analysis, rather than the intent or knowledge of a stranger to the trust. That is, the issue here is whether the breach of trust was fraudulent and dishonest, not whether the appellant's actions should be so characterized… the stranger will be liable if he or she knowingly assisted the trustee in a fraudulent and dishonest breach of trust...
>
> …
>
> Where the trustee is a corporation, rather than an individual, the inquiry as to whether the breach of trust was dishonest and fraudulent may be more difficult to conceptualize, because the corporation can only act through human agents who are often the strangers to the trust whose liability is in issue. Regardless of the type of trustee, in my view, the standard adopted by Peter Gibson J. in the Baden, Delvaux case, following the decision of the English Court of Appeal in Belmont Finance, supra, is a helpful one. I would therefore "take as a relevant description of fraud 'the taking of a risk to the prejudice of another's rights, which risk is known to be one which there is no right to take'." In my opinion, this standard best accords with the basic rationale for the imposition of personal liability on a stranger to a trust which was enunciated in In re Montagu's Settlement Trusts, supra, namely, whether the stranger's conscience is sufficiently affected to justify the imposition of personal liability. In that respect, the taking of a knowingly wrongful risk resulting in prejudice to the beneficiary is sufficient to ground personal liability. This approach is consistent with both lines of authority previously discussed.
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> …
>
> In the instant case, as a party to the contract between itself and the respondent…[the agency] knew that the Air Canada monies were held in trust for the respondent, and were not for the general use [of the agency]...Trust accounts were set up…but never used…By placing the trust monies in the general account which were then subject to seizure by the Bank,…[the agency] took a risk to the

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[47] *Ibid.* at paras. 48-53.

> prejudice of the rights of the respondent beneficiary, Air Canada, which risk was known to be one which there was no right to take. See Baden, [page827] Delvaux, supra,; Scott v. Riehl, supra. Therefore, the breach of trust…was dishonest and fraudulent from an equitable standpoint.
>
> It is clear that the appellant participated or assisted in the breach of trust.[48]

The directors were found to be personally liable for the breach of trust as constructive trustees because the requisite knowledge on the part of the directors was proved.[49]

### (b) Proprietary Remedies

Proprietary remedies are generally sought when the beneficiary wants a specific property returned rather than compensation for its loss.[50] Also, where a trustee may be relieved from responsibility for a breach of duty by statute, or where the trustee has a valid defence to a personal action, there will of course be no personal remedy available against the trustee. In these situations, proprietary remedies may be asserted.[51]

Similarly, proprietary remedies may allow beneficiaries to appropriate any increase in the value in the property subsequent to the breach.[52] They also give beneficiaries priority over other creditors of the trustee upon the trustee's insolvency.[53] "Proprietary remedies also include various means designed to enable beneficiaries to regain the trust property or its derivatives."[54] The basic principle being that traceable proceeds of trust property will themselves be trust

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[48] *Ibid.* at paras. 58-62.
[49] See also *Royal Brunei Airlines SDN. BHD v. Tan Kok Ming,* [1995] 2 A.C. 378 (P.C.) for a discussion of circumstances in which third parties (non-trustees) may become liable to account in equity.
[50] D.W.M. Waters, Q.C., Mark R. Gillen and Lionel D. Smith*, Waters' Law of Trusts in Canada*. 3rd ed. (Toronto: Thomson Canada Limited, 2005) at 1266.
[51] *Ibid.*
[52] *Ibid.* at 1269.
[53] *Ibid.*
[54] *Supra* note 2 at 674.

property, if the beneficiary so elects.[55] While the remedy of "tracing" is discussed in further detail below, it is important to note that in addition to tracing, proceedings may be brought in respect of the actual asset itself depending on how the asset was held and how the asset is being handled.

"Tracing is a method of ascertaining or identifying proprietary rights. The rules of tracing allow a party to locate value in time…If a particular claim requires the court to find where the value represented by such and such a sum of money was at some particular moments in time, it is by tracing that that finding is made."[56]

It is noteworthy that there are distinctions between the tracing available at common law and that available in equity. While the common law permits tracing into the hands of another person, there are limits on this ability, such as with property transferred into a mixed fund – such as a bank account – cannot be traced (only where the trust property remains identifiable as the product, or a converted form of the trust property, can that property be traced).[57]

To the contrary, in equity, a beneficiary can follow trust property into the hands of the trustee because the trust is a recognized vehicle. Equity also permits a beneficiary to follow property into a mixed fund and to obtain the benefit of the property purchased with that fund.[58]

While equitable tracing in circumstances where the proceeds of trust property are converted into other property is straightforward, various rules have developed over time to govern situations where the trail to locate the misappropriated trust property is not so clear. In this respect, there

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[55] *Supra* note 56 at 1267 and 1273.
[56] *Supra* note 2 at 674; See also P. Birks, "Trusts in the Recovery of Misapplied Assets: Tracing, Trust, and Restitution," in E. McKendrick, ed. *Commercial Aspects of Trusts and Fiduciary Obligations* (Oxford: Clarendon Press, 1992), 149, at 158.
[57] *Supra* note 2 at 675.
[58] *Ibid.*; Note however that equitable tracing is not available where trust proceeds are spent on services because there is no property to be ascertained and the services cannot be recovered.

are two important legal rules that apply where trustees have mixed trust property with their own property, or have combined funds from more than one trust in a mixed fund. These are the rules in *Re Hallet's Estate*[59] and in *Clayton's Case*[60].

**The Rule in *Re Hallet's Estate***

The rule in *Re Hallett's Estate* applies where trustees mix trust funds with their own funds. The rule states that where a trustee mixes trust money with his or her own money in a bank account and then withdraws money from that account, it is assumed that the trustee first took out his or her own money rather than money belonging to a trust beneficiary. Consequently, it may be seen that the rule in *Re Hallett's Estate* is based on the assumption that trustees are honest and act accordingly. Even if they do mix trust funds with their own money, it is not to be presumed that this mixture was intended to defraud the trusts of those funds.

The rule in *Re Hallett's Estate* is, however, restricted by another rule. This counterpoint provides that a person may only lay claim to a maximum value of the lowest balance in the account during the intervening period. Any amount above the lowest intermediate balance is deemed to be money replenished by the trustee and is considered to be the trustee's own money. Thus, if a trustee puts $10,000.00 of trust money into an account containing $5,000.00 of the trustee's own money, then takes out $12,000.00 and spends it, the account balance of $3,000.00 is deemed to belong to the trust. If the trustee then puts $2,000.00 into the account, raising the balance to $5,000.00, the trust beneficiaries may still claim only $3,000.00. The other $2,000.00 is deemed to be the property of the trustee. Thus, the beneficiaries have a claim *in rem* to the $3,000.00 and a claim *in personam* for $7,000.00.

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59 (1880), 13 Ch. D. 696 (Ch. Div.).
60 (1816), 1 Mer. 529, 35 E.R. 767.

## **The Rule in *Clayton's Case***

The rule in *Clayton's Case* is generally described as the "first in, first out" rule. It holds that where a trustee mixes money from two or more trusts into one account and then moves money from that account, the trustee is deemed to have taken out the money that was first deposited into the account. As the description above indicates, simply speaking, the rule contemplates as an order of deposits and withdrawals 'first in, first out'.[61]

The reason for the creation of the rule in *Clayton's Case* was to facilitate the tracing of funds in situations where the equities were equal and there may be difficulty in ascertaining the proportionate share to be awarded to each of the trusts in question. At its lowest common denominator, the rule in *Clayton's Case* is a rule of convenience and administrative expediency.

An illustration is helpful to demonstrate how the rule in *Clayton's Case* is applied in practice. Assume that a trustee deposits $5,000.00 belonging to trust "A" into a bank account. One week later, the trustee deposits $2,000.00 belonging to trust "B" into the same account. Two months later, a deposit of $3,000.00 belonging to trust "C" is made. The following week, the trustee withdraws $6,000.00 from the account. At the conclusion of these transactions, $4,000.00 remains in the account. In application, the rule in *Clayton's Case* dictates a result that trust "A" – gets nothing; trust "B" – gets $1,000.00; trust "C" – gets $3,000.00.

## **Exceptions to these Rules**

There are exceptions to both the rule in *Re Hallet's Estate* and the rule in *Clayton's Case*. In particular, the rule in *Re Hallet's Estate* only permits a beneficiary to lay claim to as a maximum value, the lowest balance in the mixed account. Any amount above the lowest intermediate

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[61] *Supra* note 2 at 681.

balance is deemed to be money replenished by the trustee and is considered to be the trustee's own money.[62]

Similarly, the rule in *Clayton's Case* is subject to the rule in *Re Hallett's Estate*. The rule in *Clayton's Case* will also not apply where:

- a trustee properly withdraws money from a mixed account for the purposes of a particular trust beneficiary, but then misappropriates it. In that case, the beneficiary may not plead the rule in *Clayton's Case* as a method of allocating the loss to another beneficiary;
- a withdrawal by the trustee is designated to a specific trust;
- the transactions in issue are entered in a bank account on the same day; and
- where all the transactions can be satisfied by the balance remaining in the account in question.

It is important to note that there are also circumstances where the rule in *Clayton's Case* has resulted in unfairness. One such example is a situation where beneficiaries "who are deserving of having their money returned from a mixed account have had to share in a shortfall with other wronged beneficiaries. In this respect, the rule in *Clayton's Case* was designed to apply only to situations where there is an unbroken, active account between the parties…In other situations where multiple trust funds are mixed together in the purchase of an asset, the trusts should share in the assets purchased in proportion to their "contributions" to the purchase."[63] Courts,

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[62] *Ibid.* at 678.
[63] *Ibid.* at 682.

however, have not always been careful to distinguish the situations in which the rule in *Clayton's Case* should be applied, which can result in the misapplication of the rule.[64]

## SUMMARY

Trustees are responsible for their actions. When a trustee has failed to act in accordance with their various responsibilities, there may be various remedies available to a trust beneficiary. The choice of the appropriate remedy may depend not only on considerations such as the nature of the breach and the facts of the particular matter, but also on the cost, process and time involved in achieving the particular remedy.

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[64] For a discussion of the misapplication of the rule in *Clayton's Case* see *Re Ontario Securities Commission v. Greymac Credit Corp.* (1986), 23 E.T.R. 81 (Ont. C.A.); See also, *supra* note 2 at 682.