<u>Trusts & Equity</u>
Fall Term 2023

Lecture Notes – No. 14

<u>XII. TRUSTEE LIABILITY</u>

A. LIABILITY OF THE TRUSTEE TO SUFFER A PERSONAL REMEDY

As we have seen, the Trustee owes fiduciary obligations and an obligation of competence to the beneficiaries of the trust. A number of personal and proprietaries remedies are available as well as a narrow trustee-specific defence.

Process: Demands for an Accounting and Passing of Accounts

> **Trustee Act, RSO 1990, c T.23**
>
> 23 (1) A trustee desiring to pass the accounts of dealings with the trust estate may file the accounts in the office of the Superior Court of Justice, and the proceedings and practice upon the passing of such accounts shall be the same and have the like effect as the passing of executors' or administrators' accounts in the court.

See sub-rules 74.16 and 74.17 of the *Rules of Civil Procedure*, RRO 1990, Reg 194 for procedures in respect of an application to pass trustee accounts.

Libertarian Investments Ltd v Hall
[2013] 16 HKCFA 93 (H.K.C.A.)

The plaintiff and defendant agreed on a plan to obtain a controlling interest in a company, TSE. Towards that end, the plaintiff transferred substantial funds to a third party and the defendant represented that the funds were used in part to acquire shares in TSE. The defendant defrauded the plaintiff of £5.5M. The matter came before the court and two issues dominated argument: (i) whether the defendant was in a fiduciary relationship to the plaintiff (which was found to be the case); (ii) if so, whether a compensatory remedy could be ordered; and, (iii) the quantification of compensation and whether considerations of causes and mitigation in common law were relevant. All members of the panel agreed that there was a fiduciary relationship between the parties.

(a) What is the relationship between a claim for compensation and an accounting?

Ribeiro J.:

> **F.6 Account and election**
>
> [97] Before leaving this discussion of the applicable principles, an incidental issue ought to be disposed of. **As part of its cross-appeal, one of the plaintiff's grounds of appeal involves the complaint that the Courts below had erred in law by**

overriding the plaintiff's election in favour of an immediate assessment of equitable compensation, compelling it instead to pursue separate proceedings involving the taking of an account.

[98] It falls to be considered later in this judgment whether a direction that an account be taken is necessary or justified. However, for the reasons given by Lord Millett NPJ in his judgment which I have had the benefit of reading in draft, **the aforesaid ground of appeal proceeds on the mistaken premise that an order for the taking of an account and an award of equitable compensation are inconsistent remedies requiring and entitling the plaintiff to make an election between the two**.

[99] **As Lord Millett NPJ points out, they are not mutually inconsistent. In a case like the present, where the account is aimed at ascertaining the true position between the fiduciary and the beneficiary, '... it can be regarded as no more than a procedure ancillary to the ascertainment of other rights'. In some cases, they may cumulatively be invoked, seeking first an account and then substantive relief. In other cases, an account may be considered unnecessary and the Court may directly award equitable compensation. It follows that no question of election arises and that ground of appeal requires no further discussion.**

Lord Millet:

[166] **There are traces in the arguments both here and below of the proposition that account and equitable compensation are alternative and inconsistent remedies and that a plaintiff must elect between them. It is only right to say at once that this is not the ground on which either court below ordered an account when the plaintiff asked for equitable compensation; but since the proposition is advanced from time to time it is appropriate to explain why it is mistaken**.

[167] It is often said that the primary remedy for breach of trust or fiduciary duty is an order for an account, but this is an abbreviated and potentially misleading statement of the true position. In the first place an account is not a remedy for wrong. **Trustees and most fiduciaries are accounting parties, and their beneficiaries or principals do not have to prove that there has been a breach of trust or fiduciary duty in order to obtain an order for account. Once the trust or fiduciary relationship is established or conceded the beneficiary or principal is entitled to an account as of right.** Although like all equitable remedies an order for an account is discretionary, in making the order the court is not granting a remedy for wrong but enforcing performance of an obligation.

[168] In the second **place an order for an account does not in itself provide the plaintiff with a remedy; it is merely the first step in a process which enables him to identify and quantify any deficit in the trust fund and seek the appropriate means by which it may be made good**. Once the plaintiff has been provided with an account he can falsify and surcharge it. If the account discloses an unauthorised disbursement the plaintiff may falsify it, that is to say ask for the disbursement to be disallowed. This will produce a deficit which the defendant must make good, either *in specie* or in money. Where the defendant is ordered to make good the deficit by the payment of money, the award is sometimes described as the payment of equitable compensation; but it is not compensation for loss but restitutionary or restorative. The

amount of the award is measured by the objective value of the property lost determined at the date when the account is taken and with the full benefit of hindsight.

[169] But the plaintiff is not bound to ask for the disbursement to be disallowed. He is entitled to ask for an inquiry to discover what the defendant did with the trust money which he misappropriated and whether he dissipated it or invested it, and if he invested it whether he did so at a profit or a loss. If he dissipated it or invested it at a loss, the plaintiff will naturally have the disbursement disallowed and disclaim any interest in the property in which it was invested by treating it as bought with the defendant's own money. If, however, the defendant invested the money at a profit, the plaintiff is not bound to ask for the disbursement to be disallowed. He can treat it as an authorised disbursement, treat the property in which it has been invested as acquired with trust money, and follow or trace the property and demand that it or its traceable proceeds be restored to the trust *in specie*.

[170] If on the other hand the account is shown to be defective because it does not include property which the defendant in breach of his duty failed to obtain for the benefit of the trust, the plaintiff can surcharge the account by asking for it to be taken on the basis of 'wilful default', that is to say on the basis that the property should be treated as if the defendant had performed his duty and obtained it for the benefit of the trust. Since *ex hypothesi* the property has not been acquired, the defendant will be ordered to make good the deficiency by the payment of money, and in this case the payment of 'equitable compensation' is akin to the payment of damages as compensation for loss.

[171] In an appropriate case the defendant will be charged, not merely with the value of the property at the date when it ought to have been acquired or at the date when the account is taken, but at its highest intermediate value. This is on the footing either that the defendant was a trustee with power to sell the property or that he was a fiduciary who ought to have kept his principal informed and sought his instructions.

[172] At every stage the plaintiff can elect whether or not to seek a further account or inquiry. The amount of any unauthorised disbursement is often established by evidence at the trial, so that the plaintiff does not need an account but can ask for an award of the appropriate amount of compensation. Or he may be content with a monetary award rather than attempt to follow or trace the money, in which case he will not ask for an inquiry as to what has become of the trust property. In short, he may elect not to call for an account or further inquiry if it is unnecessary or unlikely to be fruitful, though the court will always have the last word.

[173] In the present case the trial judge ordered accounts and enquiries because he considered that the evidence was insufficient to enable him to quantify the amount of compensation to which the plaintiff was entitled to be determined with any degree of accuracy, and his decision was affirmed by the Court of Appeal. This was an exercise of the court's discretion and as such is one which should not lightly be overturned. But the question is a procedural one and this court is in as a good a position as the trial judge to reach a decision.

(b) Principles Relating to Equitable Compensation

Ribeiro J.:

[84] In the present appeal, the plaintiff's case is that the defendant caused loss to the trust fund as a result of his breach and the controversy between the parties relates solely to the remedy of equitable compensation sought by the plaintiff.

[85] In *Nocton v Lord Ashburton*, Viscount Haldane LC noted that it was established that in cases of actual fraud, the Courts of Chancery, in both their concurrent and exclusive jurisdiction, could order the defendant 'to make restitution, or to compensate the plaintiff by putting him in as good a position pecuniarily as that in which he was before the injury'. He held that this applied equally in cases of equitable fraud, including breaches of fiduciary duty. Thus, taking the example of a solicitor who had misused his fiduciary position, his Lordship stated:

'It did not matter that the client would have had a remedy in damages for breach of contract. Courts of Equity had jurisdiction to direct accounts to be taken, and in proper cases to order the solicitor to replace property improperly acquired from the client, or to make compensation if he had lost it by acting in breach of a duty which arose out of his confidential relationship to the man who had trusted him.'

[86] As Gummow J pointed out, Viscount Haldane LC's judgment shows that:

'Where the breach of duty produces not a gain to the fiduciary but a loss to the party to whom the fiduciary duty was owed... there is an obligation to account for the loss by provision of equitable compensation.'

[87] Equitable compensation rests on the premise that the basic duty of a trustee or fiduciary who has misappropriated assets or otherwise caused loss or damage to the trust estate in breach of his duty is to restore the lost property to the trust (together with an account of profits if applicable). Where restoration *in specie* is not possible, the Court may order equitable compensation in place of restoration. As Lord Browne-Wilkinson stated:

'If specific restitution of the trust property is not possible, then the liability of the trustee is to pay sufficient compensation to the trust estate to put it back to what it would have been had the breach not been committed...'

[88] Thus, where a company was entitled to have certain shares restored to it by a director who had received the shares in breach of fiduciary duty, the Court did not consider restoration of the shares *in specie* an adequate or just remedy where their value, previously £80 per share, had dropped to £1 per share. The director was ordered instead to pay the company £80 per share with interest from the time he received them.

[89] Where the breach consists of a wilful failure by the fiduciary to carry out his fiduciary duty, his omission causing loss to the trust estate, he is liable to account on a wilful default basis. This is explained by the editors of *Snell's Equity* as follows:

'The trustee is required to restore the financial position of the trust fund to what it would have been if the trustee had not been guilty of wilful default. The effect is that the trustee must pay fresh money into the account. The trustee's liability is essentially to compensate the trust for the consequential losses that follow from the trustee's breach.'

[90] As we have seen, in pursuing the restorative objective of equitable compensation, the common law rules requiring the loss to be foreseeable and not too remote do not apply. The Court is therefore entitled to assess compensation 'with the full benefit of hindsight'.

[91] Consequently, the loss is assessed at the time of judgment and the Court is entitled to take into account any post-breach changes affecting the value of the lost trust property. McLachlin J, following Wilson J, 75 cited with approval the following passage from the judgment of Street J in *Re Dawson; Union Fidelity Trustee Co v Perpetual Trustee Co*:

'... in a claim against a defaulting trustee ... his obligation has always been regarded as tantamount to an obligation to effect restitution *in specie*; such an obligation must necessarily be measured in the light of market fluctuations since the breach of trust; and in my view it must also necessarily be affected, where relevant, by currency fluctuations since the breach.'

[92] It must however be kept in mind, as McLachlin J pointed out [in ***Canson Enterprises Ltd v Boughton & Co*, [1991] SCR 534 (S.C.C.)]**:

'While foreseeability of loss does not enter into the calculation of compensation for breach of fiduciary duty, liability is not unlimited. Just as restitution *in specie* is limited to the property under the trustee's control, so equitable compensation must be limited to loss flowing from the trustee's acts in relation to the interest he undertook to protect. Thus Davidsonstates 'it is imperative to ascertain the loss resulting from breach of the relevant equitable duty'....

[93] Where the plaintiff provides evidence of loss flowing from the relevant breach of duty, the onus lies on a defaulting fiduciary to disprove the apparent causal connection between the breach of duty and the loss (or particular aspects of the loss) apparently flowing therefrom.

[94] Tipping J so held in *BNZ v NZ Guardian Trust Co Ltd.* Similarly, when in *Maruha Corporation and Muruha (NZ) Ltd v Amaltal Corporation Ltd*, a defaulting fiduciary sought an offset against the compensation payable for its default, the Court required it to show that the proposed offset 'was an incontrovertible benefit to the person to whom the fiduciary duty was owed' emphasising 'that it is for the defaulting fiduciary to establish that such a benefit has been gained.'

[95] Another instance is found in the judgment of Mason J in *Hospital Products*, when dealing with a defaulting fiduciary who has 'so mixed an indeterminate profit with his own property as to render the identification of the gain impossible'. In such a situation, '... the whole will be treated as trust property, except so far as he may be able to distinguish what is his own'. His Honour also suggested that in a case where a fraudulent fiduciary acquired a profit through a combination of trust property and his

own property or efforts, ‘It may well be that equity in such circumstances will not seek to apportion the gain’.

[96] McLachlin J helpfully provided the following summary of the rules relating to equitable compensation [in ***Canson Enterprises Ltd v Boughton & Co*****, [1991] SCR 534 (S.C.C.)]:**

‘In summary, compensation is an equitable monetary remedy which is available when the equitable remedies of restitution and account are not appropriate. By analogy with restitution, it attempts to restore to the plaintiff what has been lost as a result of the breach, ie, the plaintiff's lost opportunity. The plaintiff's actual loss as a consequence of the breach is to be assessed with the full benefit of hindsight. Foreseeability is not a concern in assessing compensation, but it is essential that the losses made good are only those which, on a common sense view of causation, were caused by the breach. The plaintiff will not be required to mitigate, as the term is used in law, but losses resulting from clearly unreasonable behaviour on the part of the plaintiff will be adjudged to flow from that behaviour, and not from the breach. Where the trustee's breach permits the wrongful or negligent acts of third parties, thus establishing a direct link between the breach and the loss, the resulting loss will be recoverable. Where there is no such link, the loss must be recovered from the third parties.’

Campbell v Hogg
[1930] 3 DLR 673 (PC)

The trustee failed to keep accounts. Certain transactions were disputed by the beneficiary and there was no documentation to show what had in fact transpired; the trustee maintained that he gave funds to the beneficiary and the beneficiary denied that to be the case. Quite simply, the trustee had to compensate the beneficiary for the value of property which he could not account for properly.

Canson Enterprises Ltd v Boughton & Co
[1991] SCR 534

Here a solicitor acted for the purchasers in a land transaction and in the preparation of a joint venture agreement to develop it. Unknown to the purchasers, an intermediate company had bought the land from the vendors and resold it to the purchasers at a substantially higher price (they ‘flipped’ the land). The solicitor also acted for the intermediate company in its purchase and resale of the land, but did not disclose to the purchasers that the land was not being purchased directly from the vendors. The purchasers then proceeded with development of the property but suffered substantial losses when piles supporting a constructed warehouse began to sink. They obtained judgment against the soils engineers and pile-driving company they had retained, but were left with a large shortfall when these defendants could not pay. The purchasers then sued the solicitor on an agreed statement of fact. The parties agreed that the purchasers would not have purchased the property or entered into the joint venture had they known of the involvement of the intermediate company. The solicitor was held liable for breach of fiduciary duty for failing to disclose the intermediary’s purchase. The issue then was damages – *was the solicitor liable for more than the secret profit or the whole of the defendant’s loss*?

Trial:

Secret profit, as well as consequential damages of the expenses incurred on the warehouse project prior to the wrongful acts of the engineers and pile-drivers.

Court of Appeal:

A fiduciary who mishandles trust property and causes a loss is liable in damages to be calculated by analogy to trust law. The shortfall was not recoverable because such damages did not flow from the breach of fiduciary obligation but were the unrelated fault of the soils engineers and pile-driving contractor.

SCC:

The majority held that while equitable compensation is compensatory and are on par with common law damages to some extent, the principles of forseeability and remoteness play no role in respect of breach of trust (although they may in respect of breach of fiduciary duty outside breach of trust). Thus the solicitor was liable merely for returning the secret profit.

The minority held rejected the distinction between two types of fiduciary obligation and factoring in remoteness in calculating the damages – the beneficiary was entitled to be made whole again. However, causation is relevant as a matter of common sense – hence, the negligence of the engineers was not caused by the solicitor's breach of fiduciary duty.

LaForest J (for the majority) held:

82 **What is important for our purposes is the manner in which the Court of Appeal dealt with compensation, and in particular the question whether the compensation could be reduced in respect of the second investment in 1977 because of Day's contributory negligence. Like the trial judge, it concluded that it was proper to apportion the loss. In its view, not only was this justifiable on the basis of equitable principles, but law and equity had become so merged in this area that the principles of contribution should apply.** As well, judge-made law was quite properly affected by legislative action, there the Contributory Negligence Act, and by other current trends. Having reviewed a number of cases where there was an intermingling of common law and equitable principles, Cooke P. continued, at p. 451:

'These developments accord with what is probably the most authoritative modern exposition of the effect that should be accorded to the Judicature Acts in England, namely the speech of Lord Diplock in *United Scientific Holdings Ltd v Burnley Borough Council* [1978] AC 904, 924-927. As Lord Diplock put it, law and equity have mingled now; the Acts did not bring to a sudden halt the whole process of development of the common law of England that had been so notable a feature of the preceding decades; the legislation placed no ban upon further development of substantive rules by judicial decision. I respectfully subscribe to such views, as will be apparent from *Hayward v Giordani* [1983] NZLR 140, 148:

> '**Compensation or damages in equity were traditionally said to aim at restoration or restitution, whereas common law tort damages are intended to compensate for harm done; but in many cases, the present being one, that is a difference without a distinction.** There is, however, the more significant historical difference that Courts of equity were regarded as having wider discretions than common law Courts. Equitable relief was said to be always discretionary. Its grant or refusal was influenced by ideas expressed in sundry maxims. He who seeks equity must do equity. He who seeks equity must come with clean hands. Delay defeats equity. These are merely examples. Further, relief could be granted on terms or conditions.
>
> 'Whether or not there are reported cases in which compensation for breach of a fiduciary obligation has been assessed on the footing that the plaintiff should accept some share of the responsibility, there appears to be no solid reason for denying jurisdiction to follow that obviously just course, especially now that law and equity have mingled or are interacting. It is an opportunity for equity to show that it has not petrified and to live up to the spirit of its maxims. Moreover, assuming that the Contributory Negligence Act does not itself apply, it is nevertheless helpful as an analogy, on the principle to which we in New Zealand are increasingly giving weight that the evolution of Judge-made law may be influenced by the ideas of the legislature as reflected in contemporary statutes and by other current trends: compare *Dominion Rent A Car Ltd v Budget Rent a Car Systems* (1970) Ltd [1978] 2 NZLR 395, citing *Erven Warnink v J Townend & Sons (Hull) Ltd* [1979] AC 731, 743 per Lord Diplock.'

83 I agree with this approach. As I have attempted to demonstrate, it would be possible to reach this result following a purely equitable path. I agree with Cooke P. that the maxims of equity can be flexibly adapted to serve the ends of justice as perceived in our days. They are not rules that must be rigorously applied but malleable principles intended to serve the ends of fairness and justice. Viscount Haldane reminded us in *Nocton v. Lord Ashburton* of the elasticity of equitable remedies. **But in this area, it seems to me, even the path of equity leads to law. The maxim that "equity follows the law" (though I realize that it has traditionally been used only where the Courts of Chancery were called in the course of their work to apply common law concepts) is not out of place in this area where law and equity have long overlapped in pursuit of their common goal of affording adequate remedies against those placed in a position of trust or confidence when they breach a duty that reasonably flows from that position. And, as I have indicated, willy-nilly the courts have tended to merge the principles of law and equity to meet the ends of justice as it is perceived in our time.** That, in effect, is what was done in *Jacks v. Davis*, supra, and by the courts below in the instant case. As I see it, this is both reasonable and proper. It is worth observing that while the breakthrough in *Hedley Byrne & Co. v. Heller & Partners Ltd*., supra, took place in a common law context, it finds its roots in equitable principles; see Gummow in Equity, Fiduciaries and Trusts, supra, at pp. 60-61; Davidson, supra, at pp. 370-71.

<u>McLachlin J (minority) held at para 84:</u>

> **… compensation is an equitable monetary remedy which is available when the equitable remedies of restitution and account are not appropriate. By analogy with restitution, it attempts to restore to the plaintiff what has been lost as a result of the breach, i.e., the plaintiff's lost opportunity. The plaintiff's actual loss as a consequence of the breach is to be assessed with the full benefit of hindsight. Foreseeability is not a concern in assessing compensation, but it is essential that the losses made good are only those which, on a common sense view of causation, were caused by the breach. The plaintiff will not be required to mitigate, as the term is used in law, but losses resulting from clearly unreasonable behaviour on the part of the plaintiff will be adjudged to flow from that behaviour, and not from the breach. Where the trustee's breach permits the wrongful or negligent acts of third parties, thus establishing a direct link between the breach and the loss, the resulting loss will be recoverable. Where there is no such link, the loss must be recovered from the third parties.**

[subsequently quoted with approval by Binnie J. for the Court in *Cadbury Schweppes Inc. v. FBI Foods Ltd.*, [1999] 1 S.C.R. 142, para. 93. The point is accepted in the next case].

Accounting of Profits:

MacMillan Bloedel Ltd. v. Binstead
(1983), 14 ETR 269 (BSSC)

Where a company director held a share in a company purchasing chattels (logs) from his employer, and where the director does not disclose the conflict of interest and obtain consent, he will be liable for breach of fiduciary duty. The appropriate remedy is an accounting of all profits made in respect of the property purchased in breach of fiduciary duty notwithstanding that the employer has suffered no loss.

Per Dohm J:

> 60. … Where there has been a breach of fiduciary duty, as in the present circumstances, the law calls upon the Defendants to account to the plaintiff for any profit made or benefit received as a result of the breach of duty. This is not the same as paying damages, which are compensatory in nature. The purpose of damages is to put the plaintiff in the same position it would have been in if not for the wrongdoing. Here the plaintiff suffered little damage and will be in a better position than it would have been in if not for the wrongful act of the defendants.
>
> 61 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 cestu que trust. Nowhere is this principle more clearly stated than in *Boardman v. Phipps* by Upjohn, L.J.:
>
> "Rules of equity have to be applied to such a great diversity of circumstances that they can be stated only in the most general terms and applied with particular attention to the exact circumstances of each case. The relevant rule for the decision of this case is the fundamental rule of equity that a person in a fiduciary

capacity must not make a profit out of his trust which is part of the wider rule that a trustee must not place himself in a position where his duty and his interest may conflict. I believe the rule is best stated in *Bray v. Ford* by Lord Herschell, who plainly recognised its limitations:

> 'It is an inflexible rule of a Court of Equity that a person in a fiduciary position, such as the respondents, is not, unless otherwise expressly provided, entitled to make a profit; he is not allowed to put himself in a position where his interest and duty conflict. It does not appear to me that this rule is, as has been said, founded upon principles of morality. I regard it rather as based on the consideration that, human nature being what it is, there is danger, in such circumstances, of the person holding a fiduciary position being swayed by interest rather than by duty, and thus prejudicing those whom he was bound to protect. It has, therefore, been deemed expedient to lay down this positive rule."

62. Basic to the application of this principle is a determination of what is meant by the term "profit". The Oxford Dictionary describes "profit" as being "the surplus product of industry after deducting wages, cost of raw material, rent and charges". In the present circumstances then, what must be returned by the Defendants to MB is the difference between the gross earnings of MB transactions and expenses. In *Waters on Trusts*, the learned author states it in these terms:

> "In principle, if the beneficiary is enriched, he should be liable to meet the expenses of the person who has thus enriched him, and this approach is applied in those cases where the court deems a person a constructive trustee of property for another. **The constructive trustee, although he installed the improvements, for instance, thinking or intending to claim that the property in question is his own, will be held entitled to recover what he put into the property.**"

The expenses though must be proper, that is, all reasonable and necessary expenses incurred by the trustee in earning the profit.

[The principle of deducting reasonable expenses can also extend to tax liability; see *Hanson v. Clifford* (1994), 59 C.P.R. (3d) 465 (BCSC).]