Trusts & Equity
Fall Term 2024

Lecture Notes – No. 16

XII. TRUSTEE AND THIRD PARTY LIABILITY

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**
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> 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.); cb. p.1070

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); cb, p.1072

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.

Accounting of Profits:

MacMillan Bloedel Ltd. v. Binstead
(1983), 14 ETR 269 (BSSC); cb, p.1104

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).]

B. DEFENCES AND OTHER CONSIDERATIONS

(a) The Retired Trustee

A trustee is liable for acts or omissions that fail to fulfill the duty of care owed during his or her tenure as trustee. Early retirement, however, will not render the trustee safe from liability where his or her acts or omissions during administration of the trust would facilitate a breach and where the trustee retires in order to save himself or herself from liability but does nothing to prevent the breach.

Head v Gould
[1898] 2 Ch 250 (Ch.); cb, p.1114

A retired trustee may be an accessory to his or her successor's breach, but narrowly.

Per Kekewich J:

> What their successors did was to convert the whole remaining trust property and improperly to spend it. They knew that G. D. Gould was reflecting on some possible mode of assisting Mrs. Head, and he had told them, by his letter to Mr. Clapp of November 2, 1894, that he was turning his attention to some means of doing this; but apparently he was as conscious as Messrs. Houlditch & Clapp themselves of the difficulty of doing this, and he certainly never hinted at doing it in the manner ultimately adopted. On reflective study of the evidence and correspondence, and notwithstanding suspicious criticism of some unhappy expressions in Mr. Clapp's letters, I do not believe that Messrs. Houlditch and Clapp contemplated any breach of trust at all, and I am convinced that they never contemplated that actually committed. With the judgment of the Court of Appeal in *Clark v. Hoskins* before us it is easy to understand the Master of the Rolls as meaning what he probably intended to express - that **in order to make a retiring trustee liable for a breach of trust committed by his successor you must shew, and shew clearly, that the very breach of trust which was in fact committed was not merely the outcome of the retirement and new appointment, but was contemplated by the former trustee when such retirement and appointment took place.** That is clearly the doctrine of *Clark v. Hoskins.* It will not suffice to prove that the former trustees rendered easy or even intended, a breach of trust, if it was not in fact committed. They must be proved to have been guilty as accessories before the fact of the impropriety actually perpetrated.

(b) Consent, Participation, Acquiescence or Release by the Beneficiary

The beneficiary cannot claim for breach of trust if he or she assented to or concurred in the breach or, after the fact, confirmed the act or released the trustee from liability if the beneficiary is of age, has had full disclosure and knows the consequences of hir or her decision, and there is no undue influence brought to bear in him or her to decide one way or another.

Re Pauling
[1963] Ch 576; [1964] Ch 303; cb, p.1116

There was a family trust. A father and his children were amongst the beneficiaries. The father tricked the trustee into making advancements to his children for their own needs, but used the money for other purposes. The children were adults but did not object. The children brought an action against the trustee. At trial, Wilberforce J. held that when considering whether it was fair and equitable for a beneficiary who had concurred in such transactions to sue the trustee for breach of trust **the court must consider all the circumstances in which the concurrence was given, and that subject to that, it was not necessary that the beneficiary should know that what he was concurring in was a breach of trust provided that he fully understood what he was concurring in, and that it was not necessary that the beneficiary himself should have benefited by the breach of trust**. In the Court of Appeal, the position was clarified such **that the beneficiary who doesn't consent but who benefits cannot have double recovery – the benefits obtained must be deducted from the compensation due.**

C. PROTECTIVE DEVICES

(a) Exculpation Clauses

The settlor of the trust may specifically forgive the trustee for breaches of trust based on simple negligence in certain conditions (for example, that the trustee acted honestly, and, that the trustee was insured for liability for negligence). However, what of gross negligence? Here the Courts are generally hostile to enforcing such clauses.

Poche v Pihera
(1983), 16 ETD 68 (Alta. Surr. Ct.); cb. p.1142

Executrix of a trust will was found to be grossly negligent in the administration of the estate causing loss to the beneficiary of the trust, who was to receive income from the estate during her life. A second beneficiary, who was to receive the residue outright upon the death of the first beneficiary, was found to have suffered no loss.

Per Hetherington J.

> 63 Mr. Poche's will contains a number of provisions which relieves Mrs. Pihera from liability for a loss resulting from an exercise of discretion by her. Since I am not satisfied on a balance of probabilities that Mrs. Pihera exercised any discretion with respect to the matters complained of in this case, I need not consider these provisions.
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> 64 Mr. Poche's will also contains the following provision:
>
> > 8. I DECLARE that the Trustee of this my Will shall not be liable for any loss not attributable:
> >
> > (a) To her own dishonesty, or
> >
> > (b) To a wilful commission by her of any act known by her to be a breach of trust
> > ...

It was not suggested that the loss in question is attributable to Mrs. Pihera's dishonesty. Nor was it suggested that the loss is attributable to the wilful commission by her of any act. The loss is attributable to omissions by Mrs. Pihera, not to any commission. It would appear, therefore, that Mrs. Pihera is relieved from liability for this loss by para. 8 of Mr. Poche's will.

65 However, I am of the view that the conduct of Mrs. Pihera which resulted in the loss to Mrs. Poche was grossly negligent. And I am further of the view that para. 8 of Mr. Poche's will cannot relieve Mrs. Pihera from liability for a loss resulting from her gross negligence.

66 In the case of Seton v. Dawson, (1841), 4 Ct. Sess. Cas. (2d) 310, the Court was required to consider the effect of a clause quoted at p. 311 which provided as follows:

> ... and I declare that the trustees, whether originally added or assumed, shall not be liable for omissions, neglect of diligence, of any kind, nor singuli in solidum, but each only for his own actual intromissions; ...

The Court held that this clause did not relieve the trustees from liability in the circumstances of the case. Lord Cockburn, with whom Lords Justice-General (Boyle,) Mackenzie, Fullerton and Cunninghame concurred, stated at p. 317:

> We hold this total disregard of the trust, after their attention had been called, by their being required to sign the deeds, to the fact that these sums had been received, to amount to culpa lata. Though aware of the indulgence due, under such a clause, to trustees, we think that no trust property would be safe, if such gross negligence were not to make those who are guilty of it liable to the party injured.

Lord Ivory, with whom Lords Gillies and Murray concurred, stated at p. 318:

> But in no view can I hold them excusable, after putting the money into the hands of such third party, for having allowed it, or the greater part of it to remain there for a space of nine years wholly uncared for, and without so much as an account having during all that time been rendered. It is here that the gravamen of the case, as regards the trustees, in my opinion lies. For, could I get over the plea of culpa lata, as applied to this species facti, I should have been disposed, in other respects, to allow them the protection of the clause which the trust-deed contains in their favour; that protection being only to be withheld, when there is a clear case of culpa lata, which, however, I think, there unquestionably is here.

In Knox v. Mackinnon (1888), 13 App. Cas. 753 (H.L.), Lord Watson stated at p. 765:

> By the second of those clauses, it is declared that the trustees 'shall not be liable for omissions, errors, or neglect of management, nor singuli in solidum, but each shall be liable for his own actual intromissions only.' I see no reason to doubt that a clause conceived in these or similar terms, will afford a considerable measure of protection to trustees who have bona fide abstained from closely superintending the administration of the trust, or who have committed mere errors of judgment whilst acting with a single eye to the benefit of the trust, and of the persons whom it concerns. But it is settled in the law of Scotland that such a clause is ineffectual

> to protect a trustee against the consequences of culpa lata, or gross negligence on his part, or of any conduct which is inconsistent with bona fides.
>
> …
>
> **70 I am persuaded by the reasoning in these cases. In my opinion a trustee must be held responsible for any loss resulting from his gross negligence, regardless of any provision in the trust instrument relieving him from such liability.**
>
> **71 Since the conduct of Mrs. Pihera which caused Mrs. Poche's loss was grossly negligent, she is not relieved from liability for this loss by para. 8 of Mr. Poche's will.**

Armitage v Nurse
[1997] 2 All E.R. 705 (C.A.); cb, p.1144

Here a trust settlement contained a clause that provided that no trustee should be liable for any loss or damage unless it was caused by his own actual fraud. It was held that a clause excluding the liability of a trustee for equitable fraud or unconscionable behaviour was not so repugnant to the trust or contrary to public policy as to be liable to be set aside.

Millet L.J. said:

> **I accept the submission made on behalf of Paula that there is an irreducible core of obligations owed by the trustees to the beneficiaries and enforceable by them which is fundamental to the concept of a trust. If the beneficiaries have no rights enforceable against the trustees there are no trusts. But I do not accept the further submission that these core obligations include the duties of skill and care, prudence and diligence. The duty of the trustees to perform the trusts honestly and in good faith for the benefit of the beneficiaries is the minimum necessary to give substance to the trusts, but in my opinion it is sufficient.** As Mr. Hill pertinently pointed out in his able argument, a trustee who relied on the presence of a trustee exemption clause to justify what he proposed to do would thereby lose its protection: he would be acting recklessly in the proper sense of the term.
>
> …
>
> The submission that it is contrary to public policy to exclude the liability of a trustee for gross negligence is not supported by any English or Scottish authority.
>
> …
>
> At the same time, it must be acknowledged that the view is widely held that these clauses have gone too far, and that trustees who charge for their services and who, as professional men, would not dream of excluding liability for ordinary professional negligence should not be able to rely on a trustee exemption clause excluding liability for gross negligence. Jersey introduced a law in 1989 which denies effect to a trustee exemption clause which purports to absolve a trustee from liability for his own "fraud, wilful misconduct or gross negligence." The subject is presently under consideration in

> this country by the Trust Law Committee under the chairmanship of Sir John Vinelott. If clauses such as clause 15 of the settlement are to be denied effect, then in my opinion this should be done by Parliament, which will have the advantage of wide consultation with interested bodies and the advice of the Trust Law Committee.

(b) The Statutory Defence

The Trustee Act

> Protection from liability
> 28. A trustee is not liable for a loss to the trust arising from the investment of trust property if the conduct of the trustee that led to the loss conformed to a plan or strategy for the investment of the trust property, comprising reasonable assessments of risk and return, that a prudent investor could adopt under comparable circumstances.
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> Assessment of damages
> 29. If a trustee is liable for a loss to the trust arising from the investment of trust property, a court assessing the damages payable by the trustee may take into account the overall performance of the investments. s. 16 (1).
>
> Technical Breaches of Trust
> **35. (1) If in any proceeding affecting a trustee or trust property it appears to the court that a trustee, or that any person who may be held to be fiduciarily responsible as a trustee, is or may be personally liable for any breach of trust whenever the transaction alleged or found to be a breach of trust occurred, but has acted honestly and reasonably, and ought fairly to be excused for the breach of trust, and for omitting to obtain the directions of the court in the matter in which the trustee committed the breach, the court may relieve the trustee either wholly or partly from personal liability for the same.**
>
> (2) Subsection (1) does not apply to liability for a loss to the trust arising from the investment of trust property.

A trustee may be personally liable for breach of trust, unless it appears to the court that she acted (i) honestly; (ii) reasonably; and (iii) ought fairly to be excused for the breach and for not seeking direction of the court before the breach under the Trustee Act.

In ***National Trustee Co of Australia v General Finance Co of Australasia*** **[1905] AC 373, 381** it was held:

> Unless both [honesty and reasonableness] are proved the Court cannot help the trustees; but if both are made out, there is then a case for the Court to consider whether the trustee ought fairly to be excused for the breach, looking at all the circumstances.

These requirement are questions of fact and the onus of proof rests on the trustee; *Re Stuart* [1897] 2 Ch 583. Both honesty and reasonableness must be proven; *Re Rosenthal* [1972] 3 All ER 552 (T was honest but did not reasonably). The statute should be given a broad construction and the standard should be that of an ordinary honest business person. In *Re Grindey* [1898] 2 Ch 593, 601, Chitty LJ said:

> The section is not easy to construe; but in my opinion, a narrow construction ought not to be put upon it, having regard to the language used and the general object in view, which is plain, namely, the relief of honest trustees who have acted reasonably. "Reasonably" must mean reasonably as trustees.

Taking advice is not a "passport to relief":

In *Marsden v Regan* [1954] 1 WLR 423, 435 Evershed MR said:

> In this court it is our unhappy lot sometimes to come across cases in which nothing is more deplorable than the fact that a person inexperienced in matters in which he is involved fails to take advice from solicitors, who could clearly have given advice, and have protected that person from the consequences of his rash conduct. I think that one must pay some regard to the kind of station in life of the people here concerned, the character of the business, and the difficulties with which they were confronted, including the unfortunate fratricidal strife.
>
> If this court were to say that the defendant ought to have taken some further advice by way of going to counsel or applying to the judge, I think that it would shock the common sense of many people, and certainly be a most disturbing factor when other persons in like situation found themselves in the position of being personal representatives of their deceased relatives.
>
> I therefore acquit the judge entirely from the view that merely taking advice, without more, is necessarily a passport to relief, but I think with him that, in all the circumstances of the case, and bearing in mind the grave difficulties with which the defendant was confronted, it was reasonable for her, having taken the advice, and paying regard to the advice which was in fact given, to act upon it as she did.

(c) Indemnification

Generally, a trustee is liable for his or her own acts or omissions for breach of trust. If there are two or more trustees held to be liable, contribution proceedings can be instituted by the trustees to apportion liability as between themselves through indemnification (they remain jointly and severally liable to the trust, but one trustee or another may be liable to indemnify the others for his or her greater responsibility for the breach).

C. THIRD PARTY LIABLITY

In ***Barnes v Addy*** **(1874) L.R. 9 Ch. App. 244**, Lord Selborne L.C. described two distinct equitable actions available against a third party (i.e. someone outside the trust) popularly known as **'knowing receipt'** (available against a third party possessed of trust property in his or her personal capacity; i.e. not as an agent) and **'knowing assistance'** (against a third party who is an accessory to breach of trust of fiduciary duty).

- In both the areas of 'knowing receipt' and 'knowing assistance', the courts and commentators are drawn between two positions: are these forms of liability 'wrongs' (based on some degree of fault) or restitutionary responses based on unjust enrichment (favouring strict liability, subject to a defence of 'change of position')?

- The claim of a bona fide purchaser for fair value without notice of the trust supersedes claims by the trustee or beneficiary; *Nelson* v *Larholt* [1948] 1 KB 339; *Macmillan Inc* v *Bishopsgate Investment Trust (No 3)* [1995] 3 All ER 747.

- The third party in receipt of trust property disposed of in breach of trust by the trustee must be distinguished from the liability of a third party as a 'trustee de son tort'; that is, a third party who is a stranger to the trust and who intermeddles with trust property and does acts characteristic of a trustee and commits a breach of trust. The *trustee de son tort* is personally liable to account to B as well as to hold any trust property on a constructive trust; *Mara* v *Brown* [1896] 1 Ch 199; *Williams-Ashman* v *Price & Williams* [1942] Ch 219; *Re Barney* [1892] 2 Ch 265.

(a) Knowing Receipt: Third Parties in Possession

Traditionally, the liability of a stranger possessed of trust property to hold as a constructive trustee for the rightful beneficiary has been thought to be bound up with considerations of knowledge of the disposition of the trust property in a breach of trust. Thus, cases have concerned themselves with actual, implied and constructive knowledge (whether received at the time of the actual receipt or thereafter) as to the status of the property obtained as being associated with breach of trust or fiduciary duty.

Determination of a sufficient degree of knowledge for equity to consider the conscience of the third party as affected has been highly problematic; in particular, the degree to which suspicion alone would suffice as knowledge has been a source of great uncertainty. Thus it has been well recognised in recent years that the evolution of knowledge-based tests of third party fault have resulted in a complex series of technical considerations that have caused considerable frustration. An influential case has been *Baden v Societe Generale pour Favoriser le Developpement du Commerce et de l'Industrie en France SA* [1993] 1 WLR 509, 575-576 (Ch) where Peter Gibson J classified knowledge as (i) actual knowledge; (ii) wilfully shutting one's eyes to the obvious; (iii) wilfully and recklessly failing to make such inquiries as an honest and reasonable man would make; (iv) knowledge of circumstances which would indicate the facts to an honest and reasonable man; (v) knowledge of circumstances which will put an honest and reasonable man on inquiry; see also *El Ajou v Dollar Land Holdings plc* [1994] 2 All ER 685, 700 (CA). All of this is very redolent of criminal law.

One judge characterized this area as being one that has become inordinately technical and over-theorized inquiries into knowledge-based personal fault have tended towards 'tortuous

convolutions' along a 'gradually darkening spectrum where the differences [of states of mind constituting sufficient knowledge] are of degree and not kind.' In response, much scholarly work has been done in recent years to rationalize the area to provide for clearer and simpler operation. In particular, the question that has been asked whether the liability of the stranger should be strict.

Citadel General Assurance Co. v. Lloyds Bank Canada
[1997] 3 S.C.R. 805 (S.C.C.); cb. p.1201

An insurance agent sold policies underwritten by the plaintiff insurer. The agent collected premiums on behalf of the insurer, and deposited them in a general account with the defendant bank. The bank was aware that insurance premiums were being deposited into the agent's account. The agent's parent company also banked with the bank. The bank received instructions from the parent company's signing officers, who were identical to the agent's signing officers, to transfer all funds in the agent's account to the parent company's account at the end of each business day. The transfer of funds between the accounts reduced the parent company's overdraft. The agent failed to remit to the insurer premiums collected on the insurer's behalf. The agent and the parent company ceased carrying on business. The insurer brought an action against the bank for the outstanding premiums. Liability against the bank was found and a constructive trust in favour of the insurer ordered.

The rule that emerges is that there are three requisite elements in order to obtain a remedy: the property is disposed of in breach of trust or fiduciary obligation; the defendant beneficially receives the property or further property into which the trust property can be traced; the defendant has at least 'knowledge of facts sufficient to put a reasonable person on notice or inquiry.'

Per La Forest J.

> 24 The only basis upon which the Bank may be held liable as a constructive trustee is under the "knowing receipt" or "knowing receipt and dealing" head of liability. **Under this category of constructive trusteeship it is generally recognized that there are two types of cases. First, although inapplicable to the present case, there are strangers to the trust, usually agents of the trustees, who receive trust property lawfully and not for their own benefit but then deal with the property in a manner inconsistent with the trust. These cases may be grouped under the heading "knowing dealing". Secondly, there are strangers to the trust who receive trust property for their own benefit and with knowledge that the property was transferred to them in breach of trust. In all cases it is immaterial whether the breach of trust was fraudulent;** see *Halsbury's Laws of England* (4th ed. 1995), vol. 48, at para. 595; Pettit, *supra,* at p. 168; Underhill and Hayton, *Law Relating to Trusts and Trustees* (14th ed. 1987), at p. 357. The second type of case, which is relevant to the present appeal, raises two main issues: the nature of the receipt of trust property and the degree of knowledge required of the stranger to the trust.
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> 25 Liability on the basis of "knowing receipt" requires that strangers to the trust receive or apply trust property for their own use and benefit; see *Agip (Africa) Ltd. v. Jackson* (1989), [1990] 1 Ch. 265 (Eng. Ch. Div.), aff'd [1992] 4 All E.R. 451 (Eng. C.A.); *Halsbury's Laws of England, supra,* at paras. 595-96; Pettit, *supra,* at p. 168. As Iacobucci J. wrote in *Air Canada v. M & L Travel Ltd., supra,* at pp. 810-11, the "knowing receipt" category of liability "requires the stranger to the trust to

have received trust property in his or her personal capacity, rather than as an agent of the trustees". In the banking context, which is directly applicable to the present case, the definition of receipt has been applied as follows:

The essential characteristic of a recipient ... is that he should have received the property for his own use and benefit. That is why neither the paying nor the collecting bank can normally be made liable as recipient. In paying or collecting money for a customer the bank acts only as his agent. It sets up no title of its own. It is otherwise, however, if the collecting bank uses the money to reduce or discharge the customer's overdraft. In doing so it receives the money for its own benefit.... [Footnotes omitted.]; P.J. Millett, "Tracing the Proceeds of Fraud" (1991), 107 *L.Q.R.* 71, at pp. 82- 83.

...

30 Nonetheless, the respondents' arguments reflect a difficulty with the traditional conception of "receipt" in "knowing receipt" cases. **In my view, the receipt requirement for this type of liability is best characterized in restitutionary terms. In *International Corona Resources Ltd. v. LAC Minerals Ltd.,* [1989] 2 S.C.R. 574 (S.C.C.), at p. 669, I stated that a restitutionary claim, or a claim for unjust enrichment, is concerned with giving back to someone something that has been taken from them (a restitutionary proprietary award) or its equivalent value (a personal restitutionary award).** As well, in *Air Canada v. British Columbia,* [1989] 1 S.C.R. 1161 (S.C.C.), at pp. 1202-3, I stated that **the function of the law of restitution "is to ensure that where a plaintiff has been deprived of wealth that is either in his possession or would have accrued for his benefit, it is restored to him. The measure of restitutionary recovery is the gain the [defendant] made at the [plaintiff's] expense."** ...

48 Given the fundamental distinction between the nature of liability in assistance and receipt cases, it makes sense to require a different threshold of knowledge for each category of liability. In "knowing assistance" cases, which are concerned with the furtherance of fraud, there is a higher threshold of knowledge required of the stranger to the trust. Constructive knowledge is excluded as the basis for liability in "knowing assistance" cases; see *Air Canada v. M & L Travel Ltd. National Westminster Bank Ltd., supra,* at pp. 811-13. However, **in "knowing receipt" cases, which are concerned with the receipt of trust property for one's own benefit, there should be a lower threshold of knowledge required of the stranger to the trust. More is expected of the recipient, who, unlike the accessory, is necessarily enriched at the plaintiff's expense. Because the recipient is held to this higher standard, constructive knowledge (that is, knowledge of facts sufficient to put a reasonable person on notice or inquiry) will suffice as the basis for restitutionary liability.** Iacobucci J. reaches the same conclusion in *Gold National Westminster Bank Ltd., supra,* where he finds, at para. 46, that a stranger in receipt of trust property "need not have actual knowledge of the equity [in favour of the plaintiff]; notice will suffice".

...

50 Some commentators go further and argue that a recipient may be unjustly enriched regardless of either a duty of inquiry or constructive knowledge of a breach of trust. According to Professor Birks, a recipient of misdirected funds should be liable on a strict, restitutionary basis. In his article "Misdirected funds:

> restitution from the recipient", [1989] *L.M.C.L.Q.* 296, he argues that a recipient's enrichment is unjust because the plaintiff did not consent to it, not because the defendant knew that the funds were being misdirected. In particular, he writes, at p. 341, that "[t]he 'unjust' factor can be named 'ignorance', signifying that the plaintiff, at the time of the enrichment, was absolutely unaware of the transfer from himself to the defendant". Birks, however, lessens the strictness of his approach by allowing a defendant to take advantage of special defences, including a defence arising out of a bona fide purchase for value. (See also P. Birks, "Overview: Tracing, Claiming and Defences", in P. Birks, ed., *Laundering and Tracing* (1995), 289, at pp. 322 *et seq.)*
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> 51 In my view, the test formulated by Professor Birks, while not entirely incompatible with my own, may establish an unjust deprivation, but not an unjust enrichment. It is recalled that a plaintiff is entitled to a restitutionary remedy not because he or she has been unjustly *deprived* but, rather, because the defendant has been unjustly *enriched,* at the plaintiff's expense. **To show that the defendant's enrichment is unjustified, one must necessarily focus on the defendant's state of mind not the plaintiff's knowledge, or lack thereof. Indeed, without constructive or actual knowledge of the breach of trust, the recipient may very well have a lawful claim to the trust property. It would be unfair to require a recipient to disgorge a benefit that has been lawfully received. In those circumstances, the recipient will not be unjustly enriched and the plaintiff will not be entitled to a restitutionary remedy.**

(b) Third Party Accessories: Knowing Assistance

While the liability of a recipient of property transferred in breach of trust is receipt- based, the liability of a stranger who procures or assists in breach of fiduciary duty is not. Rather, it is conduct-based fault that is at issue here, and the fault of the stranger-accessory is tested without reference to any underlying fault on the part of the trustee who breaches her obligation. It is an independent form of primary liability in its own right which results in an order for the third party to compensate the beneficiary and/or disgorge his or her own profit flowing from the breach.

Air Canada v. M & L Travel Ltd.
[1993] 3 S.C.R. 787 (S.C.C.); cb, p.1174

Here a travel agency was obliged to hold the proceeds from its sale of Air Canada tickets in trust for the airline, but the agency breached its trust and used the proceeds to reduce its indebtedness to a bank. There was little question that a trust existed rather than a simple debt given that the travel agency treated the money not as its own (until the breach) but as the beneficial property of the airline.

Per Iacobucci J:

> 34 Second, strangers to the trust can also be personally liable for breach of trust if they knowingly participate in a breach of trust. The starting point for a review of the bases of this kind of personal liability is *Barnes v. Addy,* supra, which involved an estate, for which three trustees had been designated by the testator. The will allowed for the appointment of new trustees without the consent of any other party,

but did not allow for a decrease in the number of trustees. Two of the trustees died and a rift developed between the family and the third trustee, who wished to retire. He instructed his solicitor to prepare an instrument appointing Barnes, who was the husband of one of the beneficiaries, as sole trustee. The solicitor advised him against having only one trustee, but prepared the instrument on the instructions of his client. Barnes' solicitor approved the appointment. Barnes invested the trust funds for his own purposes and [page810] went bankrupt. The beneficiaries sued the previous trustee, his solicitor and Barnes' solicitor for breach of trust. The action against the solicitors was dismissed on the basis that they had no knowledge of, or any reason to suspect, a dishonest design in the transaction, and that they did not receive any trust property.

35 Lord Selborne L.C., at pp. 251-52, set out the ways in which a non- trustee can become responsible for a trust:

> Those who create a trust clothe the trustee with a legal power and control over the trust property, imposing on him a corresponding responsibility. That responsibility may no doubt be extended in equity to others who are not properly trustees, if they are found either making themselves trustees de son tort, or actually participating in any fraudulent conduct of the trustee to the injury of the cestui que trust. But, on the other hand, strangers are not to be made constructive trustees merely because they act as the agents of trustees in transactions within their legal powers, transactions, perhaps of which a Court of Equity may disapprove, unless those agents receive and become chargeable with some part of the trust property, or unless they assist with knowledge in a dishonest and fraudulent design on the part of the trustees.

In addition to a trustee de son tort, there were traditionally therefore two ways in which a stranger to the trust could be held personally liable to the beneficiaries as a participant in a breach of trust: as one in receipt and chargeable with trust property and as one who knowingly assisted in a dishonest and fraudulent design on the part of the trustees. The former category of constructive trusteeship has been termed "knowing receipt" or "knowing receipt and dealing", while the latter category has been termed "knowing assistance".

...

58 **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 the 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. *Barnes v. Addy* clearly states that the stranger will be liable if he or she knowingly assisted the trustee in a fraudulent and dishonest breach of trust. Therefore, it is the corporation's actions which must be examined. The appellant's actions will also be relevant to this examination, given the extent to which M & L was controlled by the defendant directors. The appellant's conduct will be more directly scrutinized when the issue of knowledge is under consideration. It is unnecessary, therefore, to find that the appellant himself acted in bad faith or dishonestly.**

59 **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.