In the Know on Knowing Assistance: the Ontario Court of Appeal's decision in DBDC Spadina Ltd. v Walton

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The Facts

The case involved a complex multi-million dollar commercial real estate fraud. The scheme worked essentially like this: the Walton's convinced investors to participate in real estate investments in equal-partnership, single-property ventures. Investors' contributions were matched by the fraudsters' companies. However, instead of investing their own funds, the fraudsters moved their investors' monies in and out of numerous companies, through their own "clearing houses", in a shell game. None of the agreements contemplated third-party investors in the projects, and none permitted the investors' monies to be used for anything other than the specific-project investment.

The largest investor, known as the DBDC Applicants, invested approximately $111 million into 31 specific properties. Another investor, Dr. DeJong, invested nearly $4 million in properties. There were other small investors as well.

The Majority Decision at the Court of Appeal

One of the issues that emerged on appeal was whether the Application Judge erred in holding that the fraudsters' companies were not jointly and severally liable to the DBDC Applicants on the basis of knowing assistance and/or knowing receipt.

On this issue, as Blair J.A. put it, "a stranger to a trust or fiduciary relationship may be liable under the doctrine of "knowing receipt" if the stranger receives trust property in his or her own personal capacity with constructive knowledge of the breach of trust or fiduciary duty. It is a recipient-based claim arising under the law of restitution." (para. 37)

Blair J.A. went on to explain that "a stranger to a trust or fiduciary obligation may be liable in equity on the basis of "knowing assistance" where the stranger, with actual knowledge, participates in or assists a defaulting trustee or fiduciary in a fraudulent and dishonest scheme." (para. 40) [emphasis added]

To establish a claim for knowing assistance, it must be shown that:

1. There was a fiduciary duty;
2. The fiduciary must have breached that duty fraudulently or dishonestly;
3. The stranger to the fiduciary relationship must have had actual knowledge of both the fiduciary relationship and the fiduciary's fraudulent and dishonest conduct; and
4. The stranger must have participated in or assisted the fiduciary's fraudulent and dishonest conduct.

While both knowing assistance and knowing receipt are doctrines arising in equity, they are fundamentally different. Knowing receipt liability is restitution-based and falls within the laws of restitution; its essence is unjust enrichment. Knowing assistance, on the other hand, is fault-based and is concerned with correcting matters related to the furtherance of fraud.

The majority of the Court of Appeal agreed with the Application Judge that a claim for knowing receipt could not be made out in this case. The DBDC Applicants did not pursue their rights under a previous tracing order, and they did not demonstrate the receipt of any particular funds by any of the companies, other than the funds with respect to which a constructive trusts had previously been granted.

In considering knowing assistance, however, there was no question that Ms. Walton owed the investors a fiduciary duty based on the representations she made to them and the contracts they entered into. She also knowingly breached her fiduciary obligations to the DBDC Applicants.

The crux of the issue was the liability of the companies themselves.

The majority concluded, in applying the factors from Canadian Dredge & Dock Co. [1985] 1 SCR 662, Ms. Walton acted as the directing and controlling mind of the companies, and consequently, her actions could be attributed to the companies for these purposes. The fact that Ms. Walton did not enjoy de jure control was not dispositive – what mattered was the factual reality and whether Ms. Walton actions were "within the field of operation assigned to [her]".

Blair J.A. went on to explain that the companies were not totally defrauded and, indeed, benefited at least in part from Ms. Walton's actions. They acquired properties they were created to acquire, and received funds enabling them to do so.

Contrary to the dissent, there was no need to look for any specific benefit flowing to each of the companies in order to affix the companies with Ms. Walton's knowledge for purposes of knowing assistance. Blair J.A. stated that to do so essentially collapses the knowing receipt claim into the knowing assistance claim, and there are sound policy reasons for not importing a tracing requirement into a claim for knowing assistance.

Further, the fact that the companies were also "victims" of the fraud did not render their participation in the fraudulent scheme any less relevant. Characterizing the companies as "victims" conflates the companies with their investors and preferred shareholders, and overlooks the fact that Ms. Walton was the controlling and directing mind.

Finally, what was important for Blair J.A. was not that the companies could be shown to assist in acts involving the flow of funds into the companies, but that they knowingly assisted Ms. Walton's fraudulent and dishonest scheme to divert monies out of other

companies' accounts.

Blair J.A. ruled that the companies were liable to the DBDC Applicants in the amount of $22,680,852, subject to reductions from past orders on constructive trusts.

The Dissent at the Court of Appeal

In dissent, van Rensburg J.A. disagreed with the majority and wrote: "I cannot agree with this result. In my view, the 'participation' element of the fault-based claim of knowing assistance is not made out on this record. And, in this case of first impression for our court – where a claim of knowing assistance in a breach of fiduciary duty is made by one group of defrauded investors against another similarly situated group – there is no reason to expand the equitable claim of knowing assistance beyond its proper bounds." (para. 160).

Being a mere conduit and a victim of the fraud, according to the dissent, did not transform the companies into participants in a dishonest breach of fiduciary duty. Such conduct cannot attract liability for damages.

Van Rensburg J.A. was equally concerned that there should be evidence of each company's individual benefit from the scheme in order to succeed on a claim for knowing assistance.

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