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May 5, 2023

Torts of knowing assistance and knowing receipt addressed by Ontario Court of Appeal

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In *Quantum Dealer Financial Corporation v. Toronto Fine Cars and Leasing Inc.*, 2023 ONCA 256 (CanLII), the Ontario Court of Appeal set aside a summary judgment decision against the appellant family members who had been found liable for the doctrines of knowing assistance and knowing receipt. The case addressed the circumstances in which liability may arise for turning a blind eye or otherwise failing to question the source of the funds received from someone who a party knows, or reasonably ought to have known, obtained the funds through a breach of trust.

The plaintiff corporations were in the business of financing used car inventories for motor vehicle dealers in Ontario. One of the plaintiffs' customers, Toronto Fine Cars and Leasing (TFC), was a used car motor vehicle dealership in Mississauga. TFC was owned by an individual (Diego), who was the sole director, officer and controlling shareholder.

In October 2016, the plaintiffs attended at the TFC dealership and found that Diego was not present, nor was anyone else from TFC. The premises appeared to be abandoned but for some vehicles which they had not financed. The plaintiffs later determined that the cars had been sold in the United States. The plaintiffs were unable to recover the proceeds of sale of the vehicles. Cheques from TFC were returned NSF.

The plaintiffs commenced an action alleging that Diego and TFC had fraudulently sold off the vehicles that they had financed without paying for them. The action named several other defendants who appeared to have participated in or received funds from the fraudulent scheme, including Diego's wife, who was part of the management team at TFC, her sister, a numbered company (for which the sister was the sole officer, director and shareholder), and the sister's spouse.

The plaintiffs brought a motion for summary judgment, arguing that Diego sold off practically the entire car lot overnight and dissipated the proceeds through overseas and non-arm's length transfers including to the other defendants. To conceal his fraud and to defeat creditors, Diego acquired the

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numbered company, using his sister-in-law as the putative owner and operator, while he called the shots. Diego then used the numbered company to launder funds and to flow through cash to the family member defendants.

As an example, in the two years following the sale of TFC inventory, the numbered company paid $182,233 to Diego's wife, while also paying their children's private school tuitions. The plaintiffs also alleged that Diego's sister-in-law received $175,000 from Diego's wife, ostensibly her share of the proceeds of the sale of the matrimonial home, which was then spent on a series of questionable transfers, such as sending $67,000 to a woman in Argentina for a completely undocumented business venture.

By the time of the motion, Diego's whereabouts were unknown and he was noted in default. The remaining defendants denied any wrongdoing and argued that there was no evidence that they ever received money from the plaintiffs, and that there was credible evidence that Diego's sister-in-law legitimately operated the numbered company. Diego's wife and sister-in-law claimed not to have seen Diego since October 2019 and suggested that he was now living in South America.

In February 2022, the Ontario Superior Court of Justice granted summary judgment to the plaintiffs: 2022 ONSC 1132 (CanLII). The motion judge determined that a reasonable person would have inquired into and determined that Diego and TFC had engaged in wrongdoing and that the plaintiffs' trust property was being misapplied and diverted to the families. The defendants' lack of inquiry rendered their enrichment unjust and they were held liable to the plaintiffs for the amounts traced back to the fraudulent sales of the vehicle inventory of more than $1.2 million.

In the motion judge's view, "[m]any things are possible, but only a few things are probable." The defendants' narrative was so far-fetched, internally inconsistent, and poorly documented, that their version of events was very unlikely to be true. Conversely, the explanation put forth by the plaintiffs as to the defendants working together to perpetrate a fraudulent scheme by flowing trust funds through the family members was more straightforward and accorded with the available evidence and common sense.

On appeal, the defendants argued that there was no direct evidence before the motion judge to prove that they were in receipt of the funds misappropriated by Diego, or that any of them were aware of his dishonest dealings with the plaintiffs. They submitted that motion judge erred by improperly drawing inferences of liability based largely on the rejection of their evidence.

The Court of Appeal review the related torts of knowing assistance and knowing receipt.

The tort of knowing assistance imposes liability on strangers to a fiduciary relationship who participate in a breach of trust by the fiduciary: *Caja Paraguaya de Jubilaciones y Pensiones del Personal de Itaipu Binacional v. Garcia*, 2020 ONCA 412. Liability arises from their dishonest participation in a dishonest breach of trust by the fiduciary based on the following criteria:

> (1) a fiduciary duty; (2) a fraudulent and dishonest breach of the duty by the fiduciary; (3) actual knowledge by the stranger to the fiduciary relationship of both the fiduciary relationship and the fiduciary's fraudulent and dishonest conduct; and (4) participation by or assistance of the stranger in the fiduciary's fraudulent and dishonest conduct (*DBDC Spadina Ltd. v. Walton*, 2018 ONCA 60, 419 D.L.R. (4th) 409, at para. 211, van Rensburg J.A., in a dissenting opinion adopted by the Supreme Court of Canada as its reasons on appeal, 2019 SCC 30).

The knowledge requirement encompasses actual knowledge, recklessness, or wilful blindness by the stranger assisting in the fraudulent scheme.

The elements of the tort of knowing assistance were outlined by the Court of Appeal's earlier decision of *Caja Paraguaya*, at para. 57:

> (1) the stranger receives trust property (2) for his or her own benefit or in his or her personal capacity, (3) with actual or constructive knowledge that the trust property is being misapplied. In addition to actual knowledge, including wilful blindness or recklessness, requirement (3) can be met where the recipient, having "knowledge of facts which would put a reasonable person on inquiry, actually fails to inquire as to the possible misapplication of the trust property".

The tort of knowing assistance requires a heightened level of awareness by strangers to the trust relationship, whereas knowing receipt engages a "modified objective standard" – knowledge of facts that would put a reasonable person on notice to inquire into the situation.

In the Court of Appeal's view, the summary judgment motion judge had improperly made conclusions of fact regarding the defendants' knowledge that were based largely on the rejection of their evidence rather than positive proof of liability. The plaintiffs' "explanation" that the defendants had been working in league with Diego on a fraudulent scheme to defeat his creditors, by flowing though trust funds to his family members, was nothing more than a theory.

As an example, with respect to the transfer of $67,000 to Argentina, although it was open to the motion judge to reject the wife's evidence, it did not amount to positive proof of the theory that the funds were actually directed to Diego in Argentina. The rejection of evidence did not amount to proof that other funds had been injected into the business, or that they came from the sale of the vehicles.

Overall, the Court of Appeal was concerned that there was no recognition in the motion judge's reasons that the rejection of a witness' evidence is not proof of the opposite proposition. Similarly, there was no consideration given to the role that a further finding of fabrication or concoction would be required to use the rejected evidence in the manner that he did. The evidence was not capable of establishing liability for knowing assistance and knowing receipt in relation to any of the defendants. Accepting the motion judge's rejection of the appellants' evidence, this did not amount to proof of either tort. Irregularities in the manner in which the defendants dealt with their finances did not amount to proof that the funds could be traced to Diego's wrongdoing.

In the result, the Court of Appeal set aside the summary judgment decision and remitted the case back for trial. The case demonstrates the difficult evidentiary issues that may arise when a factually complex case is adjudicated by way of summary judgment rather than trial. Although the *Rules of Civil Procedure* provide a summary motion judge with some fact-finding powers, the limited use of such powers is an issue that may be raised on appeal. In factually complex cases, it may be more efficient for a plaintiff to proceed to trial rather than attempting to win and uphold a summary judgment decision.

Contact us

If you have a litigation matter and are in need of legal advice, please do not hesitate to contact James Cook, at 416.865.6628 or jcook@grllp.com.

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