

May 9, 2023

Avenues for Recovering Fraudulently Obtained Funds When the Fraudster's Pockets are Empty

by [Corey Groper](#) and [Ryder Gilliland](#)

Establishing a fraud is only the first step. Even in the most clear-cut cases of civil fraud, actually recovering the ill-gotten gains can be a challenging and time-consuming process.

In the aftermath of a fraud, victims often learn that the perpetrator is judgment-proof, either because he or she is bankrupt, has fled the relevant jurisdiction, or has otherwise strategically disposed of assets to ensure that they are beyond the reach of creditors. In these circumstances, fraud victims are forced to consider other potential avenues to recoup their losses.

One option for those faced with a judgment-proof fraudster is to establish liability not only on the part of the perpetrator of the scheme, but also those who were accessories to (or aware of) the fraudster's conduct in some material way.

As described below, fraud victims often resort to the equitable doctrines of knowing assistance and knowing receipt to implicate those who were actively or constructively involved in a fraud, or who received or benefitted from fraudulently obtained property. Both doctrines are contingent on the existence of a fiduciary relationship between the victim and the perpetrator of the scheme.

Breach of Fiduciary Duty

In plain terms, a fiduciary is someone who is obliged, in some respects, to place another person's interests above his or her own. In this sense, fiduciary relationships are marked by vulnerability. The Supreme Court of Canada has described them as circumstances where one party has ceded power to and is "literally at the mercy" of the other.¹

¹ *Hodgkinson v. Simms*, 3 S.C.R. 377, [1994], at [paras. 129-131](#).

The three key characteristics used to identify the existence of a fiduciary relationship are:

1. The fiduciary has scope for the exercise of some discretion or power;
2. The fiduciary can unilaterally exercise that discretion or power to affect the beneficiary's legal or practical interests; and
3. The beneficiary is peculiarly vulnerable to or at the mercy of the fiduciary holding the discretion or power.²

As a result of this power imbalance, fiduciary relationships are often used as vehicles for fraud in that a fiduciary can easily abuse the power or discretion granted to him to the detriment of the beneficiary.³

In many cases, a defendant's authority, opportunity and ability to perpetrate a large-scale fraud will serve as evidence in and of itself that he possessed all the hallmarks of a fiduciary duty.⁴

Knowing Assistance

A stranger to a fiduciary relationship may be liable in equity on the basis of knowing assistance where he knowingly participates in or assists a fiduciary in a fraudulent and dishonest scheme.⁵ The idea behind the doctrine of knowing assistance is that actual knowledge of and assistance in the fraudulent conduct is sufficient to "bind the stranger's conscience", thereby giving rise to personal liability.⁶

Liability under the knowing assistance doctrine is fault-based. It requires an "intentional wrongful act on the part of the stranger to knowingly assist in the fraudulent and dishonest breach of fiduciary duty."⁷ Fraudulent and dishonest conduct means the taking of a risk by the fiduciary to the prejudice of the beneficiary where the risk is known to be one which there is no right to take.⁸

The following elements must be established in order to ground a knowing assistance claim:

1. The existence of a fiduciary duty;
2. A fraudulent or dishonest breach of that duty by the fiduciary;

² *Elder Advocates of Alberta Society v. Alberta*, 2011 SCC 24 at [para 27](#), citing *Frame v. Smith*, 1987 CanLII 74 (SCC), [1987] 2 SCR 99 at [para. 136](#).

³ *Hodgkinson*, [para. 13](#).

⁴ *Enbridge Gas Distribution Inc. v. Marinaccio*, 2012 ONCA 650, at [para 19](#).

⁵ *Li v. Zhu*, 2023 ONSC 17, at [para 52](#).

⁶ *McDonald and Dickson v. TD Bank*, 2021 ONSC 3872, at [para. 128](#) (citing: *Air Canada v. M & L Travel Ltd.*, [1993] 3 S.C.R. 787, at [para. 32](#).)

⁷ *McDonald and Dickson v. TD Bank*, 2021 ONSC 3872, at [para. 128](#) (citing: *DBDC Spadina Ltd v. Walton*, 2018 ONCA 60, 419 D.L.R. (4th) 409, at [para. 216](#).)

⁸ *DBDC*, citing: *Air Canada v. M & L Travel Ltd.*, [1993] [3 S.C.R. 787](#).

3. Actual knowledge by the third party of the fiduciary relationship and of the fiduciary's fraudulent or dishonest conduct; and
4. Participation by or assistance of the third party in the fiduciary's fraudulent or dishonest scheme.⁹

Actual knowledge includes recklessness or wilful blindness.¹⁰ In other words, a stranger must have actual knowledge of the fiduciary relationship and of the fiduciary's fraudulent and dishonest conduct or must be willfully or recklessly blind to those facts in order for liability to attach.¹¹ Constructive knowledge will not suffice.¹²

Wilful blindness “requires proof of culpable conduct that goes beyond mere negligence or laziness underlying a failure to inquire”.¹³ It is said to arise where a party is aware of the need for inquiry but declines to undertake it “because he does not wish to know the truth”.¹⁴

Knowing Receipt

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.¹⁵

The constituent elements of a knowing receipt claim are:

1. The plaintiff is the beneficiary of a trust or fiduciary relationship;
2. The defendant receives property from the trust or fiduciary in his or her personal capacity; and
3. The defendant has actual or constructive knowledge that the property was transferred to him or her in breach of a trust or fiduciary duty.¹⁶

Constructive knowledge means “that the defendant had knowledge of facts sufficient to put a reasonable person on notice or inquiry of the breach of trust.”¹⁷ It arises “where the recipient fails to make proper inquiry in

⁹ *DBDC*, at [para. 211](#), citing *Harris v. Leikin Group Inc.*, 2011 ONCA 790, at [para. 8](#).

¹⁰ *Caja Paraguaya de Jubilaciones y Pensiones del Personal de Itaipu Binacional v. Garcia*, 2020 ONCA 412, 151 O.R. (3d) 529, at [paras. 33-34](#)

¹¹ *Caja Paraguaya de Jubilaciones y Pensiones del Personal de Itaipu Binacional v. Garcia*, 2020 ONCA 412, at [para. 34](#), citing : *Air Canada*, at p. 811; see also *Harris*, at [para. 8](#).

¹² *McDonald and Dickson v. TD Bank*, [2021 ONSC 3872](#).

¹³ *1169822 Ontario Limited v. The Toronto-Dominion Bank*, 2018 ONSC 1631, at [para. 135](#)

¹⁴ *1169822 Ontario Limited*, at [para. 136](#).

¹⁵ *DBDC*, at [para. 37](#) (citing: *Citadel General Assurance Co. v. Lloyds Bank Canada*, [1997] 3 S.C.R. 805 (S.C.C.), at [para. 48](#))

¹⁶ *Boal v. International Capital Management Inc.*, 2021 ONSC 651, [para 117](#).

¹⁷ *Pardhan v. Bank of Montreal*, 2012 ONSC 2229, at [para. 142\(3\)](#), citing: *Citadel General Assurance Co.* at [paras. 48-49](#).

circumstances where an honest and reasonable person would realize that the funds transferred were from a suspicious or improper source.”¹⁸

Unlike knowing assistance, where “the defendant must be shown to have a personal, subjective mental state of knowing, being willfully blind, or being reckless about the existence of” material facts, knowing receipt is based on an objective state of knowledge where, regardless of fault, it is considered unjust for the defendant to receive and keep the enrichment.¹⁹ As such, knowing receipt sets a lower standard for its knowledge component than knowing assistance, requiring little more than proof of what a reasonable person ought to have known in the circumstances.²⁰

Key Takeaways

- To establish the tort of knowing assistance, actual knowledge, recklessness, or wilful blindness is required.
- In contrast, the tort of knowing receipt requires a reduced level of knowledge by the stranger to the fiduciary relationship.²¹
- To establish the tort of knowing assistance, it is not necessary to show that the stranger benefitted from the breach of fiduciary duty.
- Conversely, the doctrine of knowing receipt requires proof that the stranger took title to, possession of, or control over the property.²²

¹⁸ *Public Guardian and Trustee v. Chemeyko et al*, 2022 ONSC 2757, at [para. 12](#) (citing: *Homes v. Amlez International Inc.*, 2009 CanLII 58984)

¹⁹ *Boal*, at [para. 117](#).

²⁰ *Boal*, at [para 117](#).

²¹ *Quantum Dealer Financial Corporation v. Toronto Fine Cars and Leasing Inc.*, 2023 ONCA 256, at [paras. 50 & 53](#)

²² *Quantum Dealer Financial Corporation*, at [paras. 51 & 54](#)