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## *Caja Paraguaya v. Obregon* 2020 ONCA 412

The recent decision of the Ontario CA in ***Caja Paraguaya v. Obregon*** contains an interesting discussion as to the circumstances when a victim of fraud can recover against a so-called innocent spouse in the situation where the spouse did not actively participate, but perhaps ought to have known or suspected that his or her spouse was engaged in a fraud. The decision considered this issue in the context of a discussion on the related torts of knowing assistance of, and knowing receipt of breach of trust. Claims for breach of trust are an effective way to recover in respect of fraud losses, and it is always helpful when appellate courts consider this area of the law. Interestingly, this was a split decision by the Court so it is possible that this matter could end up at the SCC.

Before getting into the case at hand, a bit of background would be helpful here.

In Equity, a constructive trust arises where property (including money) is obtained by reason of fraud or theft. Thus, where money is stolen from its rightful owner, or is obtained by reason of a fraud, the owner can recover the amount stolen from any person into whose hands the money can be traced unless and until it reaches one who receives it in good faith, and for value. Thus, where money is stolen from its rightful owner, or taken from the owner in fraudulent circumstances, the recipient (such as a thief or the thief's nominee) holds such money *in trust* (albeit, a constructive trust) for such rightful owner (i.e., the beneficiary). In a sense, the holder of the stolen funds is a fiduciary *vis-a- vis* the true owner of the property. While this kind of constructive trust arises in Equity, once it exists, it represents a *property* right, and not simply an equitable one.

The right to trace and recover stolen property (i.e., an action *in rem*; meaning, as against the *property* itself rather than as against the person) exists as against any person who has taken possession of the property, until the property reaches someone who took possession as a *bona fide* purchaser for value without notice ("BFPV"). It is not uncommon, for example, for a fraudster to share some of the proceeds of fraud with his spouse, and so long as the spouse was an "innocent volunteer" (i.e., did not pay for the property, and therefore was not BFPV), and so long as the property (or its traceable proceeds) still exists, the victim will be entitled to recover it. In such a case, the innocent holder of such property really has no grounds for complaint.

But what if the property does not exist any longer; it has been spent, or gambled away or otherwise dissipated? If there is no trust property to recover, we have to sue *in personam*; namely against the fraudster and spouse, in order to obtain judgments against them that are not specific to particular assets. Certainly, a claim in fraud will always exist against the fraudster, but not as against the "innocent spouse". This is where the breach of trust claim comes in. Since a constructive trust exists in respect of traceable stolen property, the necessary implication of this is that someone who receives trust property (i.e., traceable stolen funds) and spends it, or receives the benefit of it, or otherwise put its out of the reach of the true owner, is engaged in a breach of (constructive) trust. However, the courts recognize that it may not be entirely fair to find liability against an innocent spouse who had no

knowledge of the breach of trust. This is why there is a "knowledge" requirement in breach of trust cases. This knowledge requirement will differ depending on the type of breach of trust which is being asserted.

There are two ways that a victim of theft can obtain recovery through a breach of trust claim: through the torts of (i) "knowing receipt" of; and (ii) "knowing assistance" of breach of trust. The difference between these two is that in "knowing receipt" cases, the person involved in the breach of trust received some of the proceeds of the fraud for his or her own benefit, and this person had, at the very least, "constructive knowledge" of the breach of trust; namely, even if s/he had no *actual* knowledge of the fraud, the circumstances were such that a reasonable person *ought to have known* of it, or ought to have been put on his inquiry. Constructive knowledge is an objective test; namely, the standard is for that of the proverbial "reasonable man". In a "knowing assistance" case, the tortfeasor did not receive any of the traceable proceeds of the fraud (i.e., the trust funds), but s/he must have had *actual* knowledge of the breach of trust. This is a subjective test. This knowledge component of the two torts is generally the tricky part of proving these claims, although at times, it may also be difficult to establish whether the innocent spouse received some portion of the traceable stolen funds.

The situation arises all the time in the case of the so-called "innocent spouse" where the husband and wife collectively earn a fairly modest income and yet live a much more expensive lifestyle since one spouse is supplementing the legitimate family income with the proceeds of fraud. In such a case, if the stolen money has all been spent on high living, and (for example) we cannot trace any of the stolen funds into existing assets, we can still pursue the so-called "innocent spouse" on the basis that he or she engaged in a breach of trust; namely, (i) s/he received the benefit of the dirty money, and/or helped to dissipate it (by spending it on travel, restaurants, nice cars, and high living, etc), and (ii) the circumstances were such that s/he really had to know that "extra" money was tainted in some way, and chose not to look too carefully at the source of the extra funds.

With that background, on to our case. In ***Caja Paraguaya***, the facts are not that complicated. The plaintiff (respondent in the appeal) was a Paraguayan pension fund. The pension fund invested in various funds in Canada. One Mr. Garcia orchestrated a big fraud where ultimately, some $12 million from the fund was stolen. Some $7.4 million of this money was routed through a Canadian company called Catan. Garcia's partner in crime was a man named Antonio Duscio. Antonio's wife was Leanne. Catan was owned 100% by Leanne but apparently, the company was effectively controlled by Antonio. Meanwhile, Antonio was bankrupt and the combined legitimate income of Antonio and Leanne was quite modest. Once the pension fund discovered the loss, it brought an action against multiple defendants in Canada, including Leanne. The claims against Garcia and Antonio were in, among other things, fraud. The claim against Leanne was in "knowing assistance of breach of trust".

The trial judge found that, notwithstanding Leanne's legal authority to control Catan, Antonio was the *de facto* controlling mind of the company and he made virtually all of its financial decisions. In finding that the husband was liable in fraud, the judge noted that Antonio was one of the architects of the fraud and that he knowingly and actively authorized the dissipation of funds received by Catan in circumstances where he knew or ought to have known the funds were subject to a constructive trust in the pension plan's favour. The judge found also found Leanne to be liable for knowing assistance of breach of trust. He found that her passive acquiescence in her husband's schemes went beyond mere trust and faith and crossed into wilful blindness. She knew that her husband had filed for bankruptcy, she knew of his poor financial situation that had led him to bankruptcy. Moreover, she owned a small business that was marginal in nature, and she and her husband did not officially make much money. In spite of all of this, the two of them "lived large" and she continued to sign

cheques and authorizations for large amounts of money to transit through her company without making any inquiry, in circumstances where she ought to have been put on inquiry. In the circumstances, the trial judge found that Leanne was liable for knowing *assistance* of breach of trust [the tort which requires *actual* knowledge of the breach] in the amount of $3 million (liability was joint and several with her husband). Interestingly, the judge did not apparently make the finding that Leanne was be liable in knowing *receipt*, where only constructive knowledge was needed, even though the judge could easily (in my view) have concluded that Leanne must have received some of the benefit of the stolen funds, given the couple's lavish lifestyle.

A divided Court of Appeal overturned the decision. The basis for the reversal had to do with the extent to which Leanne had knowledge of the fraudulent activity. The majority found that the trial judge erred by applying a "constructive knowledge" standard to Leanne, when an "actual knowledge" standard was required in order to find her liable for "knowing assistance". While the trial judge found that Leanne was "wilfully blind" – a standard reflecting actual knowledge of fraud – the majority found that, notwithstanding his statement in this regard, the trial judge had used language in his decision that was more consistent with a finding that Leanne had had constructive knowledge, rather than actual knowledge of the fraud. Moreover, the majority noted that even though it was agreed that, at the very least, Leanne had constructive knowledge of the fraud, the tort of knowing receipt could not be made out since the trial judge had not made the necessary factual findings to identify the precise funds that the appellant had received personally for her benefit. The majority therefore held that a new trial was appropriate on the knowing receipt issue.

Justice Pepall dissented. In her view, the trial judge made more than enough factual findings to suggest that Leanne had actual knowledge of the breach of trust. In her view, even though the trial judge used some terms which suggested a constructive knowledge standard, he also mentioned words such as "acquiescence", "facilitating" and "orchestrated", which suggested that she had had a subjective (i.e., actual) knowledge of the fraud. Justice Pepall also noted that the trial judge had outlined some of the numerous benefits received by Leanne and her husband, all of which would have allowed for a finding of knowing receipt of breach of trust in any event.

I found this decision to be somewhat frustrating, for a couple of reasons. First, it is always easier to establish that a person had constructive knowledge of a fraud, rather than actual knowledge. Thus, a plaintiff should always plead, and try to get judgment, in knowing receipt, rather than knowing assistance, because this standard of proof for the knowledge requirement is easier to establish, and is objective rather than subjective in nature. The fact that the Court of Appeal was bogged down in a discussion about whether there was actual knowledge of fraud on Leanne's part represents to me a likely failure on the part of the plaintiff to frame this case in the most advantageous way possible.

Second, the case law in this area has established held that it is often not that difficult to demonstrate on a balance of probabilities that an innocent spouse, in all likelihood, received the benefit of a fraud, and it is not always necessary to prepare a sophisticated tracing analysis. Moreover, this requirement to show that the "innocent" third party received a benefit from the stolen funds is related to the knowledge requirement in the tort; namely, if the "innocent spouse" ought to have known of, or ought to have been put on inquiry in respect of the fraud because s/he was living a lifestyle way beyond what s/he could afford, then surely this is compelling evidence that s/he was probably receiving some portion of the proceeds of the fraud. A Manitoba case I was involved in some years ago used exactly this kind of analysis to find that the "innocent" husband was liable for knowing receipt. In that case, because of the imprecise nature of the evidence as to how much of the benefit the husband received,

the motions judge held that the fair result would be to find judgment against the innocent spouse for one-half of the total amount of the fraud.

In *Caja Paraguaya*, the dissenting judge was prepared to conclude that Leanne had constructive knowledge of the fraud, in part on the basis of the lavish lifestyle she and her husband were able to lead on a modest legitimate income (and on the basis of her active participation in funds transfers). The majority was not prepared to do so, which suggests to me that the majority may have allowed itself to get caught up in an overly legalistic approach to the case, at the expense of common sense.

**R. Lester, November 20, 2020**