

CONSTRUCTIVE TRUSTS AND THE DEEMED AGENCY LIMITATION

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In *Pettkus v. Becker*, the Supreme Court of Canada developed the remedial constructive trust to prevent unjust enrichment.¹ The conditions of the remedy are (1) an enrichment accruing to the defendant, (2) a corresponding deprivation to the plaintiff, and (3) the absence of any juristic reason for the enrichment.² In addition, the court must be satisfied that the remedy is appropriate in the circumstances of the case and that a money order would not be sufficient to reverse the unjust enrichment.³ In *Soulos v. Korkontzilas*, the court held that the reversal of unjust enrichment is not the only function of the constructive trust remedy.⁴ Its other function is to prevent wrongful conduct, such as breach of fiduciary obligation. In wrongful conduct cases, there is no need for proof of unjust enrichment. Instead, the conditions are that (1) the defendant was under an equitable obligation, (2) the assets in the defendant's hands resulted from deemed or actual agency activities of the defendant, (3) the plaintiff has a legitimate reason for seeking a proprietary remedy and (4) there are no factors that would render imposition of a constructive trust unjust in all the circumstances.⁵ The subject of this comment is the second condition, the deemed agency limitation.⁶ The limitation is problematic because the court did not explain what it means or why it matters. It appears to contradict the *Soulos* proposition that the constructive trust to prevent wrongful conduct does not depend on proof of unjust enrichment.

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¹ [1980] 2 S.C.R. 834.

² *Ibid.* at 848.

³ *Rawluk v. Rawluk*, [1990] 1 S.C.R. 70.

⁴ [1997] 2 S.C.R. 217.

⁵ *Ibid.* at 241.

⁶ Previous critical commentaries on *Soulos v. Korkontzilas* deal with other aspects of the case. See especially L. Smith, "Constructive Trusts – Unjust Enrichment – Breach of Fiduciary Obligation: *Soulos v. Korkontzilas*" (1997) 76 Can. Bar Rev. 539; R. Chambers, "Constructive Trusts in Canada" (1999) 37 Alta. L. Rev. 173; and A. Duggan, "Constructive Trusts From a Law and Economics Perspective" (2005) 55 U.T.L.J. 217.

The Deemed Agency Limitation

The court in *Soulos* appeared to take the deemed agency limitation from a 1991 essay by Roy Goode.⁷ The expression Goode used was “deemed agency gains.” He defined it to mean: “gains which derive not from appropriation of property previously held by P but from activity undertaken by D for his own benefit which he was under an equitable duty, if he undertook it at all, to pursue for P, so that D in effect acted as P’s constructive agent and the resulting gains will be treated in equity as if they had in effect been procured for P.”⁸ Goode illustrated the limitation with the facts of *Cook v. Deeks*,⁹ where “D is a director who procures for himself the benefit of a contract with T which otherwise would have been procured by his company, P.”¹⁰ Other prominent cases in the same vein include *Keech v. Sandford*,¹¹ *Beatty v. Guggenheim Exploration Co.*,¹² *Regal (Hastings) Ltd v. Gulliver*,¹³ and *Boardman v. Phipps*.¹⁴ In *Soulos* itself, P and D were in an actual agency relationship, but D’s gains were still deemed agency gains in Goode’s sense. They derived not from property previously held by the plaintiff but from activity undertaken by the defendant for his own benefit which he was under an equitable duty to pursue for the plaintiff.

Goode argued that in the interest of protecting the creditors of the defendant the constructive trust remedy should depend on proof of unjust enrichment. There must be an enrichment of the defendant and a corresponding deprivation to the plaintiff. If the plaintiff suffers no deprivation, a constructive trust over the defendant’s gains would remove property from the estate of the defendant and give the plaintiff property the plaintiff did not previously own. Conversely, if the plaintiff does suffer a corresponding deprivation, a constructive trust over the defendant’s gains leaves the defendant’s estate no worse off than it would have been if the events giving rise to the plaintiff’s cause of action had not occurred.¹⁵

Goode identified three primary cases of unjust enrichment: “(1) The asset was itself transferred by P to D in circumstances such that D never had, or has lost, the right to it. (2) The asset represents the identifiable proceeds or product of another asset so transferred. (3) D intercepts money

⁷ R. Goode, “Property and Unjust Enrichment,” c. 9 in A. Burrows, ed., *Essays on the Law of Restitution* (Oxford: Clarendon Press, 1991) (cited in *Soulos* at 240-42).

⁸ Goode, *ibid.* at 219.

⁹ [1916] A.C. 554 (P.C.).

¹⁰ *Supra* note 7 at 225.

¹¹ (1736), [1558-1774] All E.R. Rep. 230.

¹² 122 N.E. 378 (N.Y.C.A. 1919).

¹³ [1967] 2 A.C. 134 (H.L.).

¹⁴ [1967] 2 A.C. 46 (H.L.).

¹⁵ *Supra* note 7 at 226.

or property to which P had a direct right against T.”¹⁶ He observed, however, that the three cases did not exhaust the possibilities. He regarded a deemed agency gain as a separate instance of unjust enrichment. The defendant’s enrichment is the realized value of the commercial opportunity the defendant took from the plaintiff, net of the defendant’s realization costs. The plaintiff’s corresponding deprivation is the unrealized value of the opportunity. The difference is that in the three primary cases of unjust enrichment, an unconditional constructive trust order will reverse the unjust enrichment, whereas in the deemed agency gains case, the constructive trust must be conditional on the plaintiff’s undertaking to reimburse the defendant’s outlay. An unconditional constructive trust order would give the plaintiff a windfall at the expense of the defendant’s other creditors.¹⁷

Soulos v. Korkontzilas

In *Soulos*, the plaintiff had employed the defendant real estate agent to purchase a property on his behalf. The defendant instead purchased the property for himself and concealed his action by telling the plaintiff that the vendor had changed his mind about selling the property. The plaintiff sued the defendant for breach of fiduciary duty and sought a constructive trust. Specifically, the plaintiff asked for the property to be transferred to him for the price the defendant had paid, subject to certain adjustments. The market value of the property had fallen since the date of the defendant’s purchase, but both parties claimed to want the property because it held a special significance for them. The defendant argued that there must be unjust enrichment before the court can award a constructive trust. There was no unjust enrichment because the market value of the property had fallen and the defendant had lost value. The Supreme Court, by a majority, rejected the defendant’s argument on two grounds. First, in wrongful conduct cases the constructive trust remedy serves a deterrence function and does not depend on proof of unjust enrichment. Second, there was unjust enrichment given the plaintiff’s desire to own the property for non-monetary reasons.¹⁸

There are difficulties with both responses. The first ground contradicts the premise of the deemed agency limitation – that reversal of unjust enrichment is the only legitimate function of the constructive trust remedy. The court instead might have concluded that deterrence was not a legitimate function of the remedy.¹⁹ That would have been consistent with

¹⁶ *Ibid.* at 225.

¹⁷ *Ibid.* at 226.

¹⁸ *Supra* note 4 at 242-43.

¹⁹ That was more or less the view the minority took. Justices Sopinka and Iacobucci held that (1) the constructive trust remedy depends on proof of unjust

the deemed agency limitation. Alternatively, it could have determined that the limitation was inapplicable. That would have been consistent with the proposition that in wrongful conduct cases there is no need for proof of unjust enrichment.

The second ground for the decision is vague as to the nature of the unjust enrichment in question. The plaintiff's deprivation was the non-monetary value he placed on the property. But what was the defendant's enrichment? Though the court did not specify, presumably it was the non-monetary value the defendant placed on the property. The story cannot end there, however, because unjust enrichment depends on a *correspondence* between the defendant's enrichment and the plaintiff's deprivation. It may not have been easy to establish that the plaintiff's non-monetary attachment to the property was the same as the defendant's, but the court did not raise the issue. Goode's main concern was the potential injustice of the constructive trust remedy to the general creditors of the defendant, rather than to the defendant personally. Assuming that the creditors had no special attachment to the property, and given the plaintiff's undertaking to reimburse the defendant's outlay, the constructive trust remedy would have made the defendant's estate no worse off. The remedy may actually have made the estate better off by ridding it of a bad bargain. These may or may not have been sufficient grounds to justify the remedy, but the court did not address them.

Soulos has potentially broad implications. Recall the facts in *Cook v. Deeks*. D, a director, procured for himself the benefit of a contract with T which otherwise would have been procured by his company, P. How would this case be decided today? *Soulos* suggests two possible approaches. The first is to treat the case as a wrongful conduct case and impose a constructive trust without reference to unjust enrichment. The second is to treat the case as an unjust enrichment case by reference to the defendant's deemed agency gains. The choice between these two approaches matters. If the court takes the first approach, it does not follow as a matter of course that it should make the remedy conditional on the plaintiff's undertaking to reimburse the defendant's outlay. If the defendant is dishonest, the court might decline to make the allowance.²⁰ Denying reimbursement of the defendant's outlay is consistent with the deterrence objective *Soulos* attributes to the constructive trust remedy in

enrichment, (2) the trial judge rejected the plaintiff's contention that the property held special value for him and there was no basis for interfering with this conclusion, and (3), given (2), there was no unjust enrichment because the plaintiff had suffered no loss (*ibid.* at 256-58). For a critique of the minority judgment, see Smith, *supra* note 6 at 546-48.

²⁰ *Boardman v. Phipps*, *supra* note 14, supports the existence of a discretion (at 104, 112). For a discussion of *Boardman v. Phipps* and other authorities, see: *Harris v. Digital Pulse Pty Ltd.* (2003), 56 N.S.W.L.R. 298 at 371-84 (C.A.).

wrongful conduct cases.²¹ On the other hand, if the court takes the second approach, there is no discretion. The court must order reimbursement of the defendant's outlay to prevent the plaintiff from obtaining a windfall at the expense of the defendant or the defendant's creditors. Denying the allowance would be inconsistent with the restitution objective implicit in the deemed agency limitation. What should a lower court do if faced with another *Cook v. Deeks*? *Soulos* seems to permit either approach.

In *Lister v. Stubbs*, the defendant purchasing officer had taken a bribe from a supplier of the plaintiff.²² The defendant profitably invested the bribe money and the plaintiff claimed a constructive trust over the defendant's investments. The court declined the constructive trust remedy, restricting the plaintiff to a personal claim for the amount of the bribe money only. According to Goode, the case is "clearly correct" because there was no unjust enrichment.²³ Specifically, there were no deemed agency gains: "[T]he bribe was not a form of benefit which it was D's duty to obtain for P; it resulted from conduct in which D ought not to have engaged at all. The distinction is between a benefit which P would have obtained if D had fulfilled his duty and a benefit which would never have been conferred at all if D had observed that duty."²⁴ More recently, however, in *Attorney-General for Hong Kong v. Reid*, the Privy Council declined to follow *Lister*, saying it was inconsistent with the principle that "a fiduciary must not be allowed to benefit from his own breach of duty."²⁵ Goode's essay was not specifically mentioned in *Reid*, but the decision is clearly at odds with the deemed agency limitation. Neither *Lister* nor *Reid* were referred to in *Soulos*. As it is, the court's adoption of the deemed agency limitation for wrongful conduct cases appears to support *Lister*. At the same time, however, the court's conclusion that in wrongful conduct cases the constructive trust remedy serves a deterrence function and that there is no need for proof of unjust

²¹ The traditional view is that equity does not punish. See *Iyse v. Foster* (1872), 8 L.R. Ch. App. 309. In *Harris v. Digital Pulse Pty Ltd.*, *ibid.* at 384, Justice Heydon said that the purpose of the discretion to deny the allowance was not punishment but "rather than an absence of grave misconduct is a passport to an indulgence in favour of the defendant." In Canada, it seems the traditional view no longer holds sway. See, for example, *Norberg v. Wynrib*, [1992] 2 S.C.R. 226 at 298-301 and *M.(K.) v. M.(H.)*, [1992] 3 S.C.R. 6 at 82 (punitive damages may be awarded for breach of equitable obligation). On this basis, a court might well rationalize the discretion in deterrence terms.

²² (1890), 45 Ch.D. 1 (C.A.).

²³ *Supra* note 7 at 231. See also P. Birks, *An Introduction to the Law of Restitution* (Oxford: Clarendon Press, 1985) at 67-70 and 387-90, and other works cited in Smith, *supra* note 6 at 544.

²⁴ Goode, *ibid.* at 231. See also R. Goode, "Proprietary Restitutionary Claims" in W. Cornish *et al.*, eds., *Restitution Past Present and Future: Essays in Honour of Gareth Jones* (Oxford: Hart Publishing, 1998) at 63.

²⁵ [1994] 1 A.C. 324 at 336.

enrichment appears to support *Reid*.²⁶ Presumably the court cannot have it both ways and at some future date it will have to make a choice.²⁷ In the meantime, the status of the deemed agency limitation remains uncertain.

The REBBA Case

Ontario (Real Estate & Business Brokers Act, Director) v. NRS Mississauga Inc. (REBBA) involved misappropriation of trust funds by a real estate broker (NRS).²⁸ Real estate agents in Ontario are required to place deposits in a separate trust account.²⁹ NRS was discovered to be insolvent after the suicide of its principal. There was a shortfall of some \$180,000 in the trust account. The funds had been misappropriated and used for day-to-day operations. NRS owned accounts receivable worth approximately \$140,000 that were subject to the perfected security interest of its bank. The Director, representing individuals who had placed money on deposit with NRS, claimed that NRS held the accounts receivable on constructive trust for the trust claimants and that they were entitled to the accounts receivable in priority to the bank. The trial judge found in favour of the claimants. The Court of Appeal reversed the decision. The accounts receivable were not traceable proceeds of the misappropriated trust funds. Justice Doherty, speaking for the court, held that the *Soulos* deemed agency limitation applied. The assets in the hands of NRS (the accounts receivable) did not result from deemed or actual agency activities in breach of equitable obligations to the trust claimants because there was no connection between any of the accounts receivable and the misappropriated trust funds.³⁰

Given the impossibility of tracing, the court's decision to refuse the constructive trust remedy was clearly correct, but the court's reading of the deemed agency limitation is a concern. The limitation has nothing to do with tracing. Its purpose, supposedly, is to provide a foundation in unjust enrichment for the constructive trust remedy in cases like *Cook v. Deeks* and, correspondingly, to prevent the courts from granting the remedy for deterrence reasons alone. None of the four *Soulos* conditions address the tracing issue. Rather, the tracing requirement is implicit, just as it is in *Pettkus v. Becker*. The majority in *Soulos* recognized that the two general bases for constructive trusts, wrongful conduct and unjust enrichment, are not mutually exclusive:

²⁶ A point previously alluded to by Smith, *supra* note 6 at 544.

²⁷ As to the considerations that should guide the court's choice, see Duggan, *supra* note 6.

²⁸ (2003), 64 O.R. (3d) 97 (Ont. C.A.).

²⁹ *Real Estate and Business Brokers Act*, R.S.O. 1990, c. R-4, s. 20(1).

³⁰ *Supra* note 28 at 108-110.

“Often wrongful acquisition of property will be associated with unjust enrichment and vice versa. However, either situation alone may be sufficient to justify imposition of a constructive trust.”³¹ That implies that in cases of overlap the plaintiff may claim the constructive trust remedy on either ground.³² *REBBA* was a case of overlap. It was a wrongful conduct case because NRS obtained property in breach of the fiduciary duty it owed to the trust claimants. It was also an unjust enrichment case because NRS was enriched and the trust claimants suffered a corresponding deprivation. It follows that the case could have been argued relying on *Pettkus*, rather than *Soulos*. There was no deemed agency limitation in *Pettkus*. Does this mean the court in an unjust enrichment case is free to grant a constructive trust remedy over assets in the defendant’s hands that are not the traceable proceeds of the property the defendant misappropriated from the plaintiff? A court would surely deny the claim on the basis that the tracing requirement is implicit.

In terms of the actual outcome in *REBBA* it does not really matter that the court imported the tracing requirement via the deemed agency limitation. There is, however, a larger issue at stake. *REBBA* could be read as suggesting that the deemed agency limitation is about tracing and nothing more. In *Serhan v. Johnson and Johnson*, Justice Cullity noted that application of the deemed agency limitation “raises a question of some difficulty.”³³ He went on to say that the condition should be confined to the particular facts in *Soulos*.³⁴ In *Soulos*, however, Justice McLachlin stated that the four conditions, including the deemed agency limitation, “generally should be satisfied” before the court awards a constructive trust remedy for wrongful conduct.³⁵ The generality of this direction tells against the interpretations of the limitation in *REBBA* and *Serhan*. In any event, the deemed agency limitation raises important policy questions about the scope of the constructive trust remedy that ought to be squarely addressed. They should not simply be swept under the carpet.

The NAIT Case

In *NAIT Academic Staff Association v. NAIT*, a collective bargaining agreement between the Northern Alberta Institute of Technology (NAIT) and the Northern Alberta Institute of Technology Academic Staff Association (NASA) obliged NAIT to obtain an insurance policy for the

³¹ *Supra* note 4 at 237.

³² Chambers, *supra* note 6 at 180.

³³ (2004), 11 E.T.R. (3d) 226 at 238 (Ont. S.C.J.).

³⁴ *Ibid.* at 238-39.

³⁵ *Supra* note 4 at 241.

benefit of NASA's members.³⁶ NAIT obtained insurance through the Mutual Life Insurance Company of Canada and the policy was registered in NAIT's name. Mutual Life subsequently demutualized, a process whereby a mutual company owned by policyholders converts to a company having a share capital. As part of that process, Mutual Life distributed a substantial surplus to policyholders in the form of shares in the new company. NAIT was issued shares worth approximately \$825,000 which it later sold. NAIT proposed to retain the sale proceeds for the purpose of offsetting future unexpected expenditure increases and other contingencies associated with the pension plan. NASA disputed NAIT's decision not to distribute the money to the employees. It brought an action alleging that the policy belonged in law or equity to the employees and that NAIT was not entitled to keep the demutualization gains for itself. NASA asked the court to declare a constructive trust in the employees' favour. At trial, Justice Wilson allowed the claim.³⁷ The Court of Appeal agreed that the employees were entitled to a constructive trust remedy, but not over the whole amount in question. NAIT and the employees had each contributed to the premium payments, and the court held that the amount of the employees' entitlement should reflect their relative contributions.³⁸

The limit the Court of Appeal imposed on the employees' entitlement exposes the trust in question for what it really was – not a constructive trust at all, but a good, old-fashioned purchase-money resulting trust.³⁹ NAIT and the employees each contributed to the premium payments. There was no presumption of advancement and so a presumption of resulting trust arose. In the absence of evidence rebutting the presumption, NAIT held the policy and its traceable proceeds on resulting trust for itself and the employees in proportions corresponding to their respective contributions. Justice Wilson mentioned resulting trusts only in passing and the Court of Appeal did not mention them at all. It would have been preferable for the court to have explicitly recognized the resulting trusts character of the remedy it granted. By choosing the constructive trust path, Justice Wilson made the resolution of the case unnecessarily complicated.

It is not clear whether the constructive trust remedy the court imposed was a constructive trust in the wrongful conduct category or the unjust enrichment category. Justice Wilson was at pains to find an agency relationship giving rise to fiduciary obligations owed by NAIT to the

³⁶ *Northern Alberta Institute of Technology Academic Staff Association v. Northern Alberta Institute of Technology* (2004), 235 D.L.R. (4th) 711 (Alta. C.A.).

³⁷ *Northern Alberta Institute of Technology Academic Staff Association v. Northern Alberta Institute of Technology* (2002), 217 D.L.R. (4th) 441 (Alta. Q.B.).

³⁸ *Supra* note 36 at 715-16.

³⁹ *Calverley v. Green* (1984), 155 C.L.R. 242 (H.C.A.).

employees, suggesting it was a constructive trust to prevent wrongful conduct. At another point in his judgment he quotes with approval from *Regal (Hastings) Ltd v. Gulliver*, again suggesting a constructive trust to prevent wrongful conduct. On the other hand, he expressly described the trust as “a constructive trust of the second category mentioned by the court in *Soulos* [to reverse unjust enrichment].”⁴⁰ The judgment of the Court of Appeal throws no light on the matter. It simply affirms the finding at trial that NAIT was the employees’ agent for the purpose of transmitting their premium contributions to Mutual Life and therefore it owed them fiduciary obligations giving rise to a constructive trust. The kind of constructive trust involved matters, because if it really was a constructive trust to reverse unjust enrichment, there was no need to find a fiduciary relationship and everything Justice Wilson said in that connection was beside the point. For a constructive trust to reverse unjust enrichment there must be (1) an enrichment accruing to the defendant, (2) a corresponding deprivation to the plaintiff and (3) an absence of any juristic reason for the enrichment. All of these elements were present in the *NAIT* case. NAIT was enriched by the demutualization payout, the employees were correspondingly deprived, and there was an absence of a juristic reason for NAIT’s enrichment because, as Justice Wilson found in an unrelated context, neither NAIT nor the employees had any reasonable expectation that gains of the kind in question would go to NAIT.⁴¹ That would have been a relatively straightforward way of resolving the case. The court, however, appears to have overlooked that approach.

Even though Justice Wilson described the constructive trust as one to reverse unjust enrichment, he applied the *Soulos* conditions for constructive trusts in wrongful conduct cases. He found that the employees paid part of the premiums with their own money and NAIT served as a conduit to Mutual Life for those payments. To that extent, NAIT was the agent of the employees and owed them fiduciary obligations. NAIT’s failure to account to the employees for the demutualization payout was a breach of fiduciary duty and that justified the constructive trust. The Court of Appeal upheld that part of Justice Wilson’s analysis. Justice Wilson stated that the agency relationship derived from an implied contract between the parties. Alternatively, he said, it was a “deemed agency” in the *Soulos* sense: “[Deemed agency relationships do] not necessarily spring from contract.... I find agency exists, and if I cannot justify it on strict black letter common law principles, I do so on the basis of a deemed

⁴⁰ *Supra* note 37 at 469.

⁴¹ *Ibid.* at 465 and 470. *Cf. International Union of Operating Engineers, Local 894 v. Smurfit-Stone Container (Canada) Inc.*, [2004] N.B.J. No. 57 (Q.B.), where Justice Leger held that the employees had no reasonable expectation of sharing in the demutualization proceeds and so there was no basis for a constructive trust remedy. The resulting trusts argument was not raised.

agency.”⁴² There are obvious difficulties with this analysis. It suggests that *Soulos* gives the courts licence to find an agency relationship regardless of the parties’ intentions, relying instead on some general notion of justice or “conscience.” That is questionable as a matter of policy. It is not, in any event, what was decided in *Soulos*. According to *Soulos*, for a constructive trust to prevent wrongful conduct, (1) the defendant must have been under an equitable obligation and (2) the assets in the defendant’s hands must be shown to have resulted from deemed or actual agency activities of the defendant in breach of the defendant’s equitable obligation to the plaintiff. Justice Wilson runs these two conditions together. Deemed agency becomes the foundation for the equitable obligation required by the first condition. That is clearly not what the Supreme Court had in mind. Deemed agency is a limiting factor in the granting of constructive trust relief, not an enabling one.

Conclusion

Soulos stands for the proposition that the constructive trust to prevent wrongful conduct does not depend on proof of unjust enrichment. However, it also says that to justify the constructive trust remedy, the assets in the defendant’s hands must be shown to have resulted from the defendant’s deemed or actual agency activities in breach of fiduciary duty to the plaintiff. These two propositions are inconsistent because the premise underlying the deemed agency limitation is that preventing unjust enrichment is the only legitimate function of the constructive trust remedy. The deemed agency limitation is unclear for this reason. It does not help matters that the court failed to explain what it meant by the deemed agency limitation, apart from its reference to Goode’s essay. For these reasons, the deemed agency limitation poses a problem for lower courts that is only just starting to emerge. In *REBBA*, the court sidestepped the problem by reading the limitation down. In *NAIT*, the court misread the limitation. These cases will almost certainly not be isolated ones. The sooner the Supreme Court can clarify the position, the better.

⁴² *Ibid.* at 468.