A TALE OF TWO CASES

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This paper examines some of the recent case law concerning the creation of a fiduciary relationship from negotiations toward a partnership or joint venture, and some of the remedies available for breach of fiduciary duty, particularly equitable damages and whether such damages should be awarded on a pre-tax or a post-tax basis.

I. INTRODUCTION

The plaintiff had the lead on a very lucrative property. The plaintiff and defendant then discussed concluding a partnership or joint venture agreement respecting the property. Some, but not all, of the details of the agreement were resolved. While negotiations continued, the defendant secured the property for its own use, eventually informing the plaintiff of that fact and that there was nothing the plaintiff could do about it. The defendant worked the property, with great success. The plaintiff sued the defendant to recover the property, or alternatively, to recover damages.

This skeletal outline is intended to resemble the facts of *International Corona Resources Ltd.* v. *Lac Minerals Ltd.*[1] Indeed, in large part the facts are similar to the facts found by the Trial Judge in *Corona*. However, the facts are taken not from the judgment in *Corona*, but from the decision of G.N. Williams J. in *Fraser Edmiston Pty. Ltd.* v. *A.G.T. (Old) Pty. Ltd.*,[2] where many of the issues addressed in *Corona* were also examined by a Judge of the Supreme Court of Queensland.

This paper will be devoted to a review of *Fraser Edmiston* and its similarity to *Corona*. Particular attention will be given to the relief granted by G.N. Williams J. in *Fraser Edmiston* in contrast to the relief ordered in *Corona*.

II. *FRASER EDMISTON*

A. THE FACTS

The plaintiff was the lessee of a store in a shopping mall. The company carried on the business of an optometry practice and the retailing of sunglasses. When the second stage of the shopping mall was nearing completion, the landlord approached the plaintiff to see if it would be interested in operating a sunglass retail store in this second stage of the mall. The store offered to the plaintiff was in a prime location in the mall and the additional store would allow the first store to be devoted to the optometry practice. The offer made to the plaintiff was attractive and, as an existing tenant, the plaintiff was only required to provide a deposit equal to one month's, as opposed to three months', rent.

The principal of the plaintiff, Mr. Edmiston, opened discussions with the Husseys regarding establishing a partnership for the purpose of operating the sunglasses store. During these discussions, the Husseys suggested that the new lease should be in the name of the defendant company, which was the Husseys' corporate vehicle. The parties had reached agreement in broad principle on establishing a partnership, but a number of issues had yet to be resolved.

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1. (1987) 62 O.R. (2d) 1, *affg.* (1986) 53 O.R. (2d) 737 (C.A.).
2. Unreported, 3 June 1986 (Qd.S.Ct.).

The parties then met with the landlord and advised the landlord that the lease would be taken in the name of the corporate defendant. A number of additional meetings also took place and at each of these meetings, Mr. Edmiston referred to Mr. Hussey as his "partner" or "new partner".

When Mr. Hussey was subsequently contacted by the proposed contractor, he advised the contractor to proceed and that he, Mr. Hussey, was taking the store by himself. Mr. Hussey then informed Mr. Edmiston of his decision. Mr. Hussey then arranged with the landlord to take the lease in the name of the corporate defendant, which was consistent with what the landlord had been told earlier.

B. THE ISSUE OF LIABILITY

G.N. Williams J. concluded that, because the parties had not agreed to certain essential terms, no partnership had been established when the corporate defendant took the premises and no partnership came into existence thereafter. But the plaintiff was nevertheless entitled to succeed, because the defendant owed the plaintiff fiduciary obligations which the defendant had breached. In so holding, the Court relied extensively on *United Dominions Corp. Ltd.* v. *Brian Pty. Ltd.*,[3] a 1985 decision of the High Court of Australia. That case, some would suggest, was also central to the decision in *Corona*.

G.N. Williams J. recognized that the facts in the case before him were distinguishable from those in *Brian Pty.* In the latter, the parties had ultimately entered into a partnership, although the breach complained of occurred before the relationship had been formalized. In *Fraser Edmiston*, as in *Corona*, on the other hand, the parties never formalized their relationship. Nonetheless, "the principles formulated in *U.D.C.* v. *Brian Pty. Ltd.* apply here, and the relief in equity can be moulded to meet the circumstances".[4] The Court found a breach of fiduciary duty based on the Husseys' "use of the Letter of Acceptance and the preferential bargaining position with the landlord, each of which was obtained from Edmiston on trust for the proposed partnership, to promote their personal interests and deprive Edmiston of his rights and interests with respect thereto".[5]

Mr. Justice G.N. Williams also commented that, even if the principles of *Brian Pty.* were not applicable, he would nonetheless have found a fiduciary relationship between the parties and a breach of the fiduciary duty owed to Edmiston by the Husseys.[6]

C. THE RELIEF GRANTED

Up to this point, the judgments in *Corona* and *Fraser Edmiston* have a great deal in common. The judgments, however, diverge on the question of remedy.

As in *Corona*, the Court in *Fraser Edmiston* held that, based on the breach of fiduciary duty owed to Mr. Edmiston, the Husseys were obligated to "account to the plaintiff for any benefit or gain which was obtained or received by reason of the opportunity or knowledge that was obtained through their fiduciary position ... and any profit resulting from the use of that property".[7] What did this mean in practical

3. (1985) 59 A.L.J.R. 676 (Aust. H.C.).
4. *Supra* n. 2 at 19.
5. *Id.* at 20.
6. *Id.* at 21.
7. *Id.*

terms? G.N. Williams J. held that the lease, obtained as a result of a breach of fiduciary duty, was subject to a trust, a trust which existed immediately before the business began operations and which was not extinguished by the exertions of the defendants.[8]

However, the Court also concluded that the defendants were entitled to a just allowance "for the time, energy and skill contributed by the defendants to maintaining and building up the value of the property subject to the trust".[9] The right to an allowance had been recognized by the House of Lords in *Boardman* v. *Phipps*.[10]

The Trial Judge proceeded to assess the defendants' allowance by awarding equitable damages to the plaintiff. Such damages were to be assessed on the basis of the "damages to which the plaintiff is entitled to compensate it in equity for the unlawful use of trust property by the defendants from December 1984 to January 1986 and the fact that the plaintiff was deprived of a share of profits of the business during that period".[11] In assessing these damages, there had to be a just allowance made for the defendants' efforts. G.N. Williams J. also held that the business (the lease and goodwill) was held on trust for the defendants and the plaintiff, and ordered the property to be sold and the net proceeds to be divided evenly between the plaintiff and the defendants.

In this latter respect, the decision of the Court in *Fraser Edmiston* appears to be a far cry from the relief granted in *Corona*. There, it will be recalled, the Court concluded that the Williams property (now the Page-Williams mine) was held by Lac on trust for Corona, and that Corona was entitled to the property on payment of certain sums. In other words, Lac was found not to be entitled to any interest in the property. (The question of Lac's entitlement to an allowance for its efforts would seem to have been left open by the Trial Judge.)

Can the decisions in *Corona* and *Fraser Edmiston*, insofar as the relief granted is concerned, be reconciled? We think that they can, and the judgment of G.N. Williams J. itself holds the key to the reconciliation. Mr. Justice G.N. Williams refers in his judgment to the decision of Kearney J. in *Timber Engineering Co. Pty. Ltd.* v. *Anderson*.[12] As in *Fraser Edmiston*, the Court in *Timber Engineering* made just allowances for the efforts of the defaulting fiduciary. But the right to just allowances, based on the profits of the business, was justified on the ground "that the nature of the business, and the manner in which it was conducted showed that the source of the profit was not capital resources, but the cash flow generated by the skill and industry of those in charge of that company's business".[13]

The reference to "capital resources" is taken directly from the *Timber Engineering* case, a case involving the appropriation of a corporate opportunity. As in *Fraser Edmiston*, the Court was prepared to make just allowances for the profit realized by one of the fiduciaries. On the other hand, it is clear, at least in Canadian law if not in the law of England and Australia, that a constructive trust is the appropriate remedy where the breach of fiduciary duty has resulted in the appropriation of a capital resource. This was the remedy granted in *Corona*, consistent with a line of Canadian

8. *Id.* at 22.
9. *Id.*
10. [1967] 2 A.C. 46 (H.L.); *see also O'Sullivan* v. *Management Agency and Music Ltd.* [1985] Q.B. 428 (C.A.).
11. *Supra* n. 2 at 26.
12. [1980] 2 N.S.W.L.R. 488 (S.C.).
13. *Supra* n. 2 at 23 (emphasis added).

cases where similar relief had been granted by the courts.[14]

The rationale for disgorgement of the capital resource is a simple one: the defaulting fiduciary should in no way be allowed to benefit from his breach of duty. To allow the defaulting fiduciary to retain an interest, let alone a substantial interest, in a capital resource property would not deter fiduciaries from acting in breach of the duty to avoid conflicts of interest. If a fiduciary were allowed to retain an interest in a capital resource property in these circumstances, the risk of getting "caught" would always be worth running, for even if "punished", the fiduciary would still be better off than if the risk had not been taken. In the case of a non-capital resource property, a different result can be justified because the property may never have been profitable without the efforts of the fiduciary, albeit those efforts followed a breach of fiduciary duty.

Finally, a just allowance may even be justified where a fiduciary has appropriated a capital resource, as in *Boardman* v. *Phipps*. The result in that case may have been warranted for either one of two reasons. Firstly, the fiduciary, while in breach of his fiduciary duty, was only technically in breach and, therefore, some allowance to the defaulting fiduciary could be justified. Secondly, the just allowance granted in that case can be seen as a means by which the Court could ensure that the defaulting fiduciary was not penalized for his technical breach, in the sense of being out of pocket for the appropriation of the trust property and its continued nurturing.

III. EQUITABLE DAMAGES

The *Fraser Edmiston* and *Corona* cases raise the question of when a constructive trust is an appropriate remedy and when equitable damages will be sufficient relief. We have already suggested that a constructive trust is appropriate where the breach of fiduciary duty has resulted in the fiduciary acquiring a capital resource that rightly belongs to the beneficiary. On the other hand, equitable damages would seem to be more appropriate in non-capital resource property cases, where it is much more difficult to say precisely what capital has been acquired by the defaulting fiduciary, and where, perhaps, it is difficult to differentiate for the purpose of imposing a trust between the capital appropriated and the capital developed by the fiduciary. Because of this difficulty, a trust in favour of the fiduciary might be too generous to the beneficiary and too harsh to the defaulting fiduciary. Consequently, damages equal to the profit realized by reason of the breach of trust are awarded to the beneficiary.[15]

This statement concerning the nature of the damages awarded for breach of a fiduciary duty is obviously different from the damages awarded for breach of contract or for a tort. In the case of the former, the damages awarded are to put the innocent party in the same position he would have been if the contract had been performed. In the case of the latter, damages are awarded to put the plaintiff in the position he would have been but for the tort. In each case, the damages are plaintiff-oriented in the sense that the damages are assessed having regard to the plaintiff's loss. Equitable damages, on the other hand, are defendant-oriented in the sense that the damages are assessed having regard to the defendant's gain (as opposed to the plaintiff's loss). In this sense, equitable damages are akin to an accounting for profits.

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14 Perhaps the two most important cases in this regard are *Mcleod* v. *Sweezey* [1944] S.C.R. 111 and *Pre-Cam Exploration and Development Ltd.* v. *McTavish* [1966] S.C.R. 551.

15. *Supra* n. 10. For an excellent discussion of equitable damages, *see* P. Birks, "Restitutionary Damages for Breach of Contract: *Snepp* and the Fusion of Law and Equity" [1987] *L.M.C.L.Q.* 421.

The importance of equitable damages in the fiduciary context as well as in breach of confidence cases (which may or may not overlap) is highlighted in the spy cases, *U.S.* v. *Snepp*[16] and the *Spycatcher*[17] controversy. In each case, an agent employed in the government's security service published memoirs in breach of his contract of employment and in breach of his obligation of confidence. In each case, the memoirs proved to be highly successful publishing ventures (aided and abetted by the government's public displeasure with the publication). If a claim in contract had been brought, the plaintiff would obviously have had difficulty establishing with any degree of precision the loss flowing from the contractual breach. By contrast, a claim for equitable damages for breach of confidence would be much less problematical, because the damages are gauged not by the plaintiff's loss but by the defendant's gain. That was precisely the relief secured in *Snepp* and is the relief claimed against Peter Wright and his publishers in the *Spycatcher* litigation.

In the *Corona* case, much was made about the proper method for assessing damages if the Court decided not to impose a constructive trust. The defendant, Lac Minerals Ltd., argued that damages should be assessed on the basis approved in *Seager* v. *Copydex Ltd. (No. 2)*,[18] as further refined by *Dowson & Mason Ltd.* v. *Potter*.[19] In essence, these cases, Lac argued, required damages to be assessed (at least insofar as the claim was put on the basis of breach of confidence) so as to quantify the value of the information imparted to Lac by Corona and improperly used by Lac. This exercise would require a court, in effect, to give the information a market value and that value was to be equated with the loss suffered by Corona.

This analysis misses the mark on a number of counts. Firstly, the damages, if assessed in the manner proposed by Lac, would focus on the "loss" to the plaintiff rather than the defendant's gain and would be inconsistent with the notion of an accounting for profits or equitable damages, which, as we have pointed out earlier, focuses on the defendant's gain. Secondly, the method of assessment approved in *Seager* and even in *Dowson* would seem to be inappropriate in a case where use of the information by the defendant does not simply permit the defendant to compete with the plaintiff in the market place (which the *Seager* and *Dowson* cases recognize as inevitable in the manufacturing context), but use of the information effectively ousts the plaintiff from the market place. After all, if, as in fact was the case, Lac obtained the property, Corona is deprived of the property. Put somewhat differently, where improper use of confidential information or breach of fiduciary duty deprives the plaintiff of a capital resource, damages should be assessed on the basis of the value of the resource rather than on the basis of the value of the information.

Moreover, if one considers the purpose of the method of assessment adopted in *Seager* and *Dowson*, one quickly recognizes that the method adopted creates in such cases a sufficient deterrent against breach of confidence. The result in each of these

16. 100 S.Ct. 763 (1980), *revg.* in part *U.S.* v. *Snepp* 595 F.2d 926 (1979) and reinstating the judgment of Lewis J., 456 F.Supp. 176 (1978).

17. The *Spycatcher* controversy refers to the litigation arising out of the publication of the memoirs of Peter Wright, a former member of the British secret service. Attempts to enjoin publication of the memoirs have, for the most part, been unsuccessful, even though the Government of the United Kingdom was able to obtain an interlocutory injunction preventing serialization of the book in British newspapers: *see A.G.* v. *Guardian Newspapers Ltd.* [1987] 1 W.L.R. 1248 (H.L.). The Courts dealing with the interlocutory proceedings have assumed that the appropriate remedy available to the Government is an accounting for profits by Wright and his publishers, as in *U.S.* v. *Snepp*, *id.*

18. [1969] 2 All E.R. 718 (C.A.).

cases is that the defendant has been deprived of the profits acquired by reason of the breach of confidence (which may coincidentally equal the plaintiff's loss). This, of course, is also the result achieved by the Trial Judge and the Court of Appeal in *Corona*.

IV. TAX AND BREACH OF FIDUCIARY OBLIGATIONS

One of the issues raised in *Corona* and discussed in the judgment of the Trial Judge but not in the Court of Appeal, is whether damages, if awarded, should be assessed on a pre- or post-tax basis. While damages for economic loss ordinarily are assessed on a post-tax basis, this approach can be justified because these damages are intended to compensate the plaintiff for its loss, whether the claim sounds in contract or in tort. As pointed out above, however, equitable damages are intended to deprive the defendant of the gain realized by reason of the breach of fiduciary duty. Given that the tax status of damage awards is at the best of times a difficult question, and given the purpose of equitable damages, it is not surprising that some courts have recently held that such damages should be determined on a pre-tax basis. The rationale for this approach was expressed in unequivocal terms by Vinelott J. in *Re Bell's Indenture*.[20] This case concerned a breach of trust involving the misappropriation of trust money rather than breach of a fiduciary duty. However, just as courts have recognized the link between breach of trust and breach of fiduciary duty for other purposes of the law, so there would seem to be no good reason why the tax issue should be decided differently in a case involving a breach of fiduciary duty as opposed to a breach of trust. The words of Vinelott J. ring equally true in both instances:[21]

> There can to my mind be no doubt that a trustee who has himself defrauded his beneficiaries by taking trust moneys for his own purposes is liable to restore the moneys he has taken without regard to any fiscal liabilities that might have fallen on the trust fund if he had not misappropriated the funds. If, as a result of, for instance, a decision of the Estate Duty Office not to charge estate duty on the restored fund there is a windfall, the windfall cannot be allowed to benefit the defaulting trustee. Equally, if he has sold an investment in order to misappropriate the proceeds, he must restore the investment or if it is shown or admitted that the investment would have been sold at a later date (as in the case of *Churchill Farm*) restore its value at that later date.
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> In my judgment no valid distinction can be drawn between the position of a trustee who has misappropriated for his own benefit and a trustee who has deliberately misappropriated trust moneys for the benefit of someone else. It would to my mind be absurd to impose a lesser liability to a trustee who has deliberately misappropriated trust moneys by paying them to, for instance, his wife or children.

Finally, we should make a few brief comments on an issue that has undoubtedly attracted the attention of tax practitioners, but one that only recently has become the subject of judicial decision — that is, the tax status of a constructive trust. Should a constructive trust be subject to the same rules as express trusts? And if the answer to this question is in the affirmative, when should the trust be considered to come into existence?

These questions were recently considered in *Fletcher* v. *M.N.R.*[22] The Court in *Fletcher* held, relying on *Pettkus* v. *Becker*[23] and without much discussion, that a

19. [1986] 2 All E.R. 418 (C.A.).
20. [1980] 3 All E.R. 425 (Ch.); *see also Bartlett* v. *Barclay's Bank Trust & Co. Ltd.* [1980] Ch. 515 and *John* v. *James* [1986] S.T.C. 352 (Ch.).
21. *Id.* at 441.
22. (1987) 41 D.T.C. 624 (T.C.).
23. [1980] 2 S.C.R. 834.

constructive trust may exist before the Court declares its existence. Interestingly, this was the view adopted by the Court in *Fraser Edmiston*, although the Court in *Corona* was somewhat more equivocal. The Court also concluded that a constructive trust came within the definition of trust in the Income Tax Act. Having regard to the proliferation of fiduciary duty cases and the courts' greater willingness to invoke the remedial constructive trust, the *Fletcher* decision is probably not the last word on the taxation of constructive trusts.

V. CONCLUSION

This paper began with a discussion of the *Fraser Edmiston* decision and continued with a comparison between that case and the *Corona* case. There are obvious similarities between the two decisions, including a judicial willingness to find a fiduciary relationship where parties are negotiating toward a partnership or joint venture. The two cases clearly suggest that not all negotiations will result in the imposition of fiduciary obligations. But they do support the conclusion that negotiations which entail one party placing itself in the hands of the other — by giving one party the power to injure the other — and the purpose of which is to conclude an agreement combining the efforts of the parties for their collective benefit, will give rise to fiduciary obligations and, in particular, the duty not to appropriate the object of the relationship for oneself to the exclusion of the other party.

Fraser Edmiston also provides clear support for the proposition that was much debated in *Corona*, that is, whether a fiduciary relationship exists where parties are negotiating toward a partnership or joint venture and no agreement is ever concluded by the parties. The *Brian Pty.*[24] case relied on by *Corona* was, of course, a case in which the partnership agreement was ultimately concluded, but a breach occurred before the relationship was fully formalized.

Again, in *Fraser Edmiston*, unlike in *Corona*, the issue of whether the parties had been negotiating seriously or had "embarked" on the joint venture did not arise.

On the other hand, the remedial relief granted in *Fraser Edmiston*, at least superficially, differs substantially from that granted in *Corona*. However, as we have tried to point out, the object of the relief granted is identical — to force the defaulting fiduciary to disgorge the profits realized as a result of the breach. Given the nature of the trust property in *Fraser Edmiston*, the Court believed that this object could be best achieved by an award of equitable damages, making just allowances for the efforts of the defaulting fiduciaries. G.N. Williams J. implicitly recognized that this approach would not be adequate in the case where the fiduciary appropriates a capital resource having some intrinsic value. *Corona*, of course, was a case involving just such a capital resource. Thus, *Fraser Edmiston* and *Corona* should be seen as two points on a continuum rather than two cases that support the granting of different relief for similar wrongs.

24. *Supra* n. 3.