

Case Law Update: Credifinance Securities Limited v DSLC Capital Corp

March 30, 2011

2011 ONCA 160 (Released March 2, 2011)

Trustee Constructive Trust Fraud Bankruptcy

In this case, the Court of Appeal for Ontario explained the conditions under which a constructive trust remedy can be granted in favour of defrauded creditors after the fraudster enters into bankruptcy proceedings.

After Credifinance Securities Limited (“Credifinance”) made an assignment into bankruptcy, DSLC Capital Corp. (“DSLC”) filed a proof of claim in the amount of \$400,000 in accordance with section 81 of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 (the “BIA”). The proof of claim maintained that \$310,500 in the possession of Credifinance was DSLC’s property. The Trustee of Credifinance denied the claim. DSLC appealed the decision to the Superior Court on the basis that it was a victim of a fraud and therefore a constructive trust should be granted in its favour.

The Superior Court judge found that DSLC had been defrauded into loaning Credifinance the \$400,000 and granted a constructive trust over what remained of the loan on the basis that it did not form part of the bankrupt estate. The trustee appealed the factual and jurisdictional basis for the decision to the Court of Appeal.

In its judgment, the Court of Appeal discussed the process for appeals under the BIA. In *obiter*, the court commented that the British Columbia approach of hearing the matter as a true appeal makes more sense than the Ontario approach of potentially hearing it as a hearing *de novo* instead of as a true appeal, the policy rationale for the B.C. approach being that trustees in bankruptcy should be regarded as having experience and expertise in the area of business financing, restructurings and insolvency. However, since the parties did not raise this issue the court did not comment on it further.

In upholding the Superior Court judge’s decision, the court found that the remedy of a constructive trust is expressly recognized in bankruptcy proceedings, although the test for proving such a constructive trust is difficult to meet. The court stated that where the bankrupt and the creditors would benefit from the bankrupt’s misconduct, a constructive trust may be granted to prevent an injustice. The court agreed with the Superior Court judge that DSLC met the test for a constructive trust and noted that the only creditors of Credifinance were its lawyers and the individual who controlled Credifinance. However, the court warned that the reasons of the Superior Court judge should not be interpreted as meaning that a constructive trust will always be imposed in cases where a civil fraud by the bankrupt on a claimant is proven and the funds are traceable.

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