

Unauthorized Dispositions of Trust Property: Tracing in Quebec Law

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Article abstract

The trustee of a Quebec trust is an administrator of the property of others, with full administration. As such, he holds a wide range of powers over the trust property; typically, his powers will exceed his authority, in the sense that it will be possible for him to make unlawful dispositions of the trust property. In such a case, he will be liable of course, but sometimes, particularly if the trustee is insolvent or absent, it will be important to understand the effects of the unauthorized dispositions on the trust property. For example, it may be possible for beneficiaries or other interested parties to annul a disposition of trust property; in this way, the property may be restored to the trust patrimony. Somewhat more difficult is the case in which the trustee has improperly disposed of trust property in exchange for some other property, in an attempt to misappropriate trust assets and turn them to his own benefit. If it is not possible to annul the disposition, might it be possible to claim that the proceeds of this unauthorized disposition are themselves held in trust? This paper examines the extent to which the idea of real subrogation can be used to protect the trust patrimony. Although the Supreme Court of Canada has suggested that Quebec law does not have a general principle of real subrogation, the author argues that this principle has a role to play in protecting universalities of law and that it can appropriately be invoked in the context of unauthorized dispositions of trust property.

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UNAUTHORIZED DISPOSITIONS OF TRUST PROPERTY: TRACING IN QUEBEC LAW

*Lionel Smith**

The trustee of a Quebec trust is an administrator of the property of others, with full administration. As such, he holds a wide range of powers over the trust property; typically, his powers will exceed his authority, in the sense that it will be possible for him to make unlawful dispositions of the trust property. In such a case, he will be liable of course, but sometimes, particularly if the trustee is insolvent or absent, it will be important to understand the effects of the unauthorized dispositions on the trust property. For example, it may be possible for beneficiaries or other interested parties to annul a disposition of trust property; in this way, the property may be restored to the trust patrimony. Somewhat more difficult is the case in which the trustee has improperly disposed of trust property in exchange for some other property, in an attempt to misappropriate trust assets and turn them to his own benefit. If it is not possible to annul the disposition, might it be possible to claim that the proceeds of this unauthorized disposition are themselves held in trust? This paper examines the extent to which the idea of real subrogation can be used to protect the trust patrimony. Although the Supreme Court of Canada has suggested that Quebec law does not have a general principle of real subrogation, the author argues that this principle has a role to play in protecting universalities of law and that it can appropriately be invoked in the context of unauthorized dispositions of trust property.

Le fiduciaire d'une fiducie québécoise est un administrateur du bien d'autrui, chargé de la pleine administration. À ce titre, il est doté d'un vaste éventail de pouvoirs sur les biens en fiducie; il est pourtant possible que le fiduciaire fasse des dispositions illégales des biens en fiducie et outre passe ses pouvoirs. Il engagera alors sa responsabilité personnelle, mais dans les cas où le fiduciaire est insolvable ou absent, il peut être important de connaître également les effets de ces dispositions non autorisées sur les biens en fiducie. Par exemple, les bénéficiaires ou toutes autres parties intéressées peuvent faire annuler une disposition illégale; de cette façon, les biens sont remis dans le patrimoine fiduciaire. Par contre, si le fiduciaire a disposé d'un bien en fiducie en échange d'un autre bien, dans le but de s'emparer des biens en fiducie et d'en profiter personnellement, la situation devient plus complexe. S'il n'est pas possible d'annuler la disposition, est-il possible de prétendre que le produit de cette disposition non autorisée entre lui-même dans le patrimoine fiduciaire? Ce texte examine comment la subrogation réelle peut être utilisée pour protéger le patrimoine fiduciaire. Bien que la Cour suprême du Canada ait suggéré que le droit québécois ne connaît pas de principe général de subrogation réelle, l'auteur soutient que la notion a un rôle à jouer dans la protection des universalités de droit, et qu'elle peut justement être mise en œuvre dans le contexte des dispositions non autorisées des biens en fiducie.

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Introduction

The coming into force of the *Civil Code of Québec* (CCQ) brought with it a wholly renewed trust institution. Given that robust protection for beneficiaries is an important aspect of any law of trusts, one aspect of the new regime that attracted some initial commentary was whether the Quebec trust could admit of a form of tracing. John Brierley argued that it could, by the civilian technique of real subrogation.¹ But very little has been written since then, and there is no significant jurisprudence. This paper seeks to explore some of these possibilities, albeit in a preliminary way.

When a trust is managed well, there is usually little cause for complaint. But a trust can be badly managed by a trustee in a whole range of ways. This paper is concerned with one particular kind of mismanagement: the unlawful disposition of trust assets. Typically, this involves an attempt by a trustee to misappropriate the value held in trust, either for his own benefit or for the benefit of someone else.

There are two distinct problems that must be addressed in this context. One is the problem of trust assets improperly transferred to another person: can they be recovered? The other is the problem of an asset that has been improperly acquired by using trust assets: can those new assets be treated as trust property?

There is a tendency to conflate these two issues, for example by treating them as variations on a single question: in light of what has happened to the trust property, can it be recovered in whatever guise it bears now? But they are juridically distinct possibilities. This can be illustrated by considering a simple example. The trustee misappropriates \$10,000 from the trust and uses it to buy a car, registering himself as the owner. We may be tempted to think merely in terms of a single question: can the misappropriated property be traced? But there are two distinct possibilities in this scenario. One is to argue that the \$10,000, even though it has been paid to another person, is recoverable as property that still belongs to the trust. The other is to argue that the car, having been acquired with trust property, is itself trust property. Not only are they distinct, they are probably theoretically inconsistent with each other; *on ne peut pas avoir le beurre et l'argent du beurre*.

¹ John EC Brierley, "The New Quebec Law of Trusts: The Adaptation of Common Law Thought to Civil Law Concepts" in H Patrick Glenn, ed, *Droit québécois et droit français : Communauté, autonomie, concordance* (Cowansville, Que: Yvon Blais, 1993) 383 at 390-92. See also John B Claxton, *Studies on the Quebec Law of Trust* (Toronto: Thomson Carswell, 2005) at paras 1.70-71, 17.14-15.

When we are following original assets into different hands and trying to recover them, we may call this “following”.² When we are attempting to lay claim to assets *that have never been trust assets*, on the basis that they were *acquired with* trust assets, we are doing something different. In this paper, this is what is meant by a claim that is based on the process of tracing.³

The focus in this paper is on trusts. However, if tracing is available in the context of misappropriated trust property, it is quite possible that the same technique could operate in other contexts; for example, where a mandatary misuses property belonging to the mandator, or an administrator of the property of a natural person misuses property under administration.

I. Recovery of Original Property

The main technique for recovering trust property that has been improperly disposed of will be via the annulment of the relevant disposition.

If the trustee were simply to give trust property away, for example, to a family member, the donation would clearly be null. The reason is that, except in very limited circumstances, an administrator of the property of others has no power to make gifts of the property being administered.⁴ Although the CCQ is not entirely clear, this appears to be a relative nullity.⁵

Once the donation is annulled, the general conclusion is that the ownership of the property in question will return to the trust patrimony.⁶ The regime of restitution of prestations will apply.⁷ One interesting question is that of who can demand annulment of such a juridical act. This standing belongs to “the person in whose interest” the nullity is established;⁸ normally, this means a person who was party to the juridical act in question.

² Hence, when a person with a real right seeks to assert that right even though the thing is in the hands of a new person, we speak of the person’s “right to follow” or “*droit de suite*”.

³ Quebec cases suggest that the French terminology for the process of tracing may be *re-tracage*: see e.g. *Fonds Norbourg Placements équilibrés (Liquidation de)*, 2006 QCCS 4072, [2006] RJQ 1848, aff’d 2007 QCCA 1076, [2007] RJQ 1890; *Bouloud (Syndic de)*, 2010 QCCS 4840, [2010] RJQ 2478.

⁴ See arts 1307 *a contrario*, 1315 CCQ.

⁵ See Madeleine Cantin Cumyn, *L’administration du bien d’autrui* (Cowansville, Que: Yvon Blais, 2000) at paras 341, 349 [Cantin Cumyn, *L’administration du bien*].

⁶ See art 1422 CCQ.

⁷ See arts 1699-707 CCQ. See also Brierley, *supra* note 1 at 395.

⁸ Art 1420 CCQ.

But in the case of the trust, the solution is more complicated. The beneficiaries are not parties to the act that is null, but the nullity exists to protect them. It seems to follow that they are able to invoke it.⁹ It appears that the nullity may also be invoked by those to whom the CCQ gives powers of supervision over the trust.¹⁰

Let us take a slightly more difficult case: not a donation, but a sale. Moreover, let us assume that the sale is made to the trustee: to use the earlier example, the trustee misappropriates \$10,000 from the trust and uses it to buy a car. We may assume that the sale is unlawful, being either contrary to the terms of the trust or made in breach of the trustee's duty of loyalty. Either of these conditions is enough to make the sale null, in principle.¹¹ But it is likely to be much harder to annul the sale, for a variety of reasons. Of course, if the seller of the car was or should have been aware of the trustee's breach of trust, the sale can be annulled, and the money can be recovered according to the regime for restitution of prestations, with such a seller surely treated as one in bad faith. But the other possibility is that the seller was in good faith and neither knew nor had reason to know that the trustee had misappropriated trust property. In this case, the seller will be protected by the law, because although the trustee lacked or misused the power to enter into the sale, the third party had no way to know this. The latter's reliance, in good faith, on the appearance of regularity will afford him a defence to an action in nullity.¹²

⁹ See Cantin Cumyn, *L'administration du bien*, *supra* note 5 at para 342. Cantin Cumyn suggests that only beneficiaries with an existing interest, and not an eventual interest, have standing: *ibid* n 973. Japanese law explicitly allows trust beneficiaries to annul unauthorized juridical acts of the trustee, even though the beneficiary is not a party to the act in question: *Trust Act*, Law No 108 of 2006, art 27 (Japan), online: Japanese Law Translation <<http://www.japaneselawtranslation.go.jp>> (an English translation sponsored by the Japanese Ministry of Justice).

¹⁰ See arts 1287-92 CCQ; Cantin Cumyn, *L'administration du bien*, *supra* note 5 at para 149. These persons include the settlor or his heirs, the beneficiaries, in some cases a curator or the Public Curator (see art 1289 CCQ), and for some purposes, "any ... interested person" (see arts 1290-91 CCQ). One example of such an interested person might be a successor trustee or co-trustee to the trustee whose juridical act is null. The supervisory organ contemplated in article 1288 has not been created.

¹¹ See Cantin Cumyn, *L'administration du bien*, *supra* note 5 at para 329 (lack of power to carry out the juridical act); *ibid* at para 331 (power exists but is used for an improper purpose).

¹² See *ibid* at paras 345-48. Cantin Cumyn notes that a great deal will turn on context: *ibid* at para 348. For instance, if the trustee were the *seller* of immovable trust property, then the land register would probably show him as owner of the land in his capacity of trustee: see art 1278 CCQ. In this case, the buyer would not be able to say that he was unaware of the trust, although he may still be able to show that he believed, in good faith, that the trustee was acting lawfully. Apart from protection based on appearances, there are of course other possible defences to an action in nullity, including prescription.

II. Recovery of Proceeds

This brings us, then, to the question of proceeds. In our example, if the trustee's purchase of the car cannot be annulled, is it still possible to claim that the car itself is held in trust? There will, of course, be a claim for compensation for any loss caused to the trust patrimony by the trustee's breach. But if, for example, the trustee is insolvent, this claim may be worthless. It may be important, in such a case, to know whether the car can be claimed as trust property. Another context in which this may be important is one in which the acquired property has increased in value. Assume that the trustee's breach consisted of an unauthorized purchase of securities or land or some other investment. It is possible that the value of these purchased assets may be *greater* than the amount of trust money that was unlawfully used to acquire them. In such a case, the trust beneficiaries would be aided if the law permitted them to claim that the proceeds of an unauthorized disposition of trust property are themselves held in trust.¹³

In the context of the Quebec trust, the question can be formulated in terms of patrimonies. Let us return to the original example of the car purchased with trust property. The question is whether the car (or, we might better say, ownership of the car) is in the personal patrimony of the trustee or rather is in the trust patrimony.

In an ordinary case, this question would be answered by an examination of the effects of the relevant juridical acts. In the Quebec law of sale, ownership of a car is translated to the buyer's patrimony by the effect of the contract itself.¹⁴ It seems to follow that, since both the seller and the buyer (the trustee) intended that the effect of the contract of sale would be to transfer ownership of the car to the trustee's personal patrimony, this would indeed be the effect. Such a result may seem to follow even more strongly if the property in question is such that there is a register or some other documentary evidence of ownership. In our example of the car, there is a vehicle registration. To take another example, if the property acquired in breach of trust is a number of corporate shares, there will be a shareholder register that indicates who holds the shares from time to time.¹⁵ Similarly, if the property acquired by the trustee is an immovable,

¹³ The possibility of laying claim to traceable proceeds is quite developed in the common law. For some discussion of these and other motivations for using this technique, see Lionel D Smith, *The Law of Tracing* (Oxford: Clarendon Press, 1997) at 24-47 [Smith, *Tracing*].

¹⁴ See art 1453 CCQ. The effect, however, may be delayed, as in an instalment sale: see arts 1745-49 CCQ.

¹⁵ The shareholder register is not necessarily determinative if the shares are held through a securities intermediary. In this case, there will be other records showing the

there will be an entry in the land register. In all of these cases, if the trustee is acting unlawfully and seeking to misappropriate the property, the documentary evidence will not indicate that he holds the land in his capacity as trustee. It would seem to follow that the property in question is in the personal patrimony of the trustee and not in the trust patrimony.

The same considerations can apply in relation to some kinds of intangible property. If the property is a credit balance in a bank account, as where the trustee misappropriates trust money and deposits it into his own personal bank account, the account is a debt governed by a contract; the debt is owed by the bank to the person with whom it has contracted. Since the contract in this case is with the trustee in his personal capacity, and all the documentation will reflect this, the conclusion would seem to follow that the bank balance is in the trustee's personal patrimony, not in the trust patrimony.

In these cases, where there is some documentary evidence of the ownership of property, it is clear that if the trustee had been acting lawfully, the relevant documents would reveal that the assets belonged to the trust patrimony; they should mention the trustee as the holder of the relevant property, while indicating that he is acting in his capacity as such.¹⁶ Does it follow that, if the documents do not mention that the trustee is acting in his capacity, the property in question must be in his personal patrimony?

I would argue that it does not follow. We are assuming that the trustee has improperly purchased an asset using trust property, and that it was the common intention of the transferor (who may or may not have known about the trust) and of the trustee that the trustee should become the owner of the asset. The question under consideration is whether such an asset does indeed fall into the personal patrimony of the trustee, on the basis of this common intention; or, on the contrary, whether the law can override their intention, and reach the conclusion the asset instead falls into the trust patrimony, on the ground that the asset was acquired with property improperly taken from the trust patrimony.

If the law can override their intention in this way, then it must be possible whether or not there is any documentary evidence of ownership of the asset. In relation to many kinds of property—for example, gold bullion or a painting—there will be no such documentary evidence. But even where such documentation exists, it is only accurate insofar as it reflects the legal position. If the parties' intention is not always determinative of ownership, it would simply follow that in such a case, the ownership doc-

security entitlements: see *An Act respecting the transfer of securities and the establishment of security entitlements*, RSQ c T-11.002, s 103(1).

¹⁶ See art 1278 CCQ.

umentation was inaccurate, just as it may be in cases involving mistaken or fraudulent transfers of property.

III. Real Subrogation

A. Definition and Examples

What is the legal technique that may be capable of overriding the common intention of the seller and the trustee, thereby allowing us to draw the conclusion that the purchased asset falls into the trust patrimony? The most relevant possibility is real subrogation. This technique, or doctrine, can be defined as the “[r]eplacement of ... property for other property in a juridical relationship.”¹⁷ As in French law, there are some specific codal provisions that provide in different ways for real subrogation.

For example, articles 450–451 of the CCQ set out what is the “private property” of a spouse, in the matrimonial regime called the partnership of acquests. Private property is excluded from division when the regime comes to an end. The CCQ provides that private property includes both property that is acquired to *replace* private property and property that is acquired *with* private property.¹⁸

Another example is seen in the provisions on the substitution, which “exists where a person receives property by a liberality with the obligation of delivering it over to a third person after a certain period.”¹⁹ The first person is called the institute, and the other is called the substitute; the CCQ provides that “the institute is the owner of the substituted property, which forms, within his personal patrimony, a separate patrimony intended for the substitute.”²⁰ At the “opening” of the substitution, when ownership passes to the substitute, the institute must deliver the relevant property to the substitute; and the CCQ provides that “[w]here the substi-

¹⁷ F Allard et al, eds, *Private Law Dictionary and Bilingual Lexicons: Property* (Cowansville, Que: Yvon Blais, 2012) *sub verbo* “subrogation”. In the same sense, see *Encyclopédie juridique Dalloz : Répertoire de droit civil*, looseleaf consulted on 23 March 2013, “Subrogation réelle” by Éric Savaux, No 1.

¹⁸ See arts 450(3), 451 CCQ. Article 451 goes into more detail on the outcome in situations where property is acquired partly with private property and partly with other property. See also art 457 CCQ.

¹⁹ Art 1218 CCQ.

²⁰ Art 1223 CCQ.

tuted property is no longer in kind, the institute delivers over whatever has been acquired through reinvestment.”²¹

As a final example, real subrogation may apply in the case of a hypothec. Where a creditor holds a hypothec on a universality or on an individual thing, the hypothec can extend to property that replaces the original property, if the latter has been alienated.²² In the case of a hypothec on an individual thing, if there is no replacement, the hypothec can extend to property acquired with the original thing.²³

There are, therefore, a number of codal examples of real subrogation, often using the language of “replacement”, “reinvestment”, “acquired with”, or of “proceeds”. As in French law, these discrete examples create the following difficulty: do these provisions illustrate a more general principle, which may operate in other contexts without specific legislative authority? Or do they instead show that the general principle is that real subrogation does not operate, unless there is such specific authority?²⁴ As we will see, it is possible that the answer lies somewhere in between.

B. Kinds of Real Subrogation

Although the phrase “real subrogation” has a pleasingly technical ring to it, its meaning and scope are far from clear. It is sometimes used in what may be called a merely descriptive sense. Consider the discussion of real subrogation in Aubry and Rau’s classic analysis of the patrimony:

Taken in its broadest sense, real subrogation is a fiction according to which one object replaces another so that it becomes the property of the person who owned the first object and is clothed with that object’s juridical nature.

... Where an act resulting respectively in the alienation and acquisition of property causes an object to leave a universality of law, it stands to reason that the alienated object be replaced, as an element forming part of this universality, by the object so acquired.²⁵

²¹ Art 1244, para 2 CCQ. Failing any property acquired by reinvestment, the institute must transfer the value of the property at the time of the original alienation to the institute.

²² See art 2674, paras 1-2 CCQ.

²³ See art 2674, para 3 CCQ.

²⁴ See Frédéric Zenati-Castaing & Thierry Revet, *Les biens*, 3d ed (Paris: Presses Universitaires de France, 2008) at para 156.

²⁵ C Aubry & C Rau, *Cours de droit civil français d’après la méthode de Zachariæ* (Paris: Imprimerie et librairie générale de jurisprudence Marchal et Billard, 1873) vol 6 at para 575(2). For an English translation, see Nicholas Kasirer, “Translating Part of

Whether “fiction” is the right label has been much discussed.²⁶ But there is some consensus that this “broadest sense” is not particularly useful. In the case discussed by Aubry and Rau, a person alienates an asset, transferring it out of his patrimony, in order to acquire some other, new asset. But real subrogation is not needed in order to explain why the acquired object forms part of the patrimony; the intentions of the parties adequately explain the result. This can be demonstrated by considering the case in which a person receives a donation. The gifted property forms part of his patrimony, but there is no substitution of one thing for another. In other words, we need only say that, as a starting point at least, rights fall into the patrimony of the person to whom they are transferred; real subrogation is neither necessary nor sufficient to explain this.²⁷

Leaving aside this very wide sense of real subrogation, there are still other distinctions that can be drawn. Just as with personal subrogation, it is possible to differentiate conventional real subrogation from legal real subrogation.²⁸ Within legal real subrogation, one can distinguish different effects. Building on the writing of the glossators, many civilian systems draw a distinction between real subrogation in universalities and real subrogation relating to particular assets.²⁹ In the former, the technique of real subrogation is used to justify the conclusion that, where a thing belongs to a universality, then if it be alienated, the price received will itself belong to that universality. The kinds of universalities that exist may vary from one system to another, but we have already seen examples in Quebec law: the private property of a spouse in a matrimonial regime, the property in a substitution, or property subject to a hypothec of a universality.³⁰

As for real subrogation relating to particular assets, in this context the technique is used in this situation to transmit a juridical characteristic from one thing to its substitute in the same patrimony. An example in

France’s Legal Heritage: Aubry and Rau on the Patrimoine” (2008) 38:2 RGD 453 at 476-77 [footnotes omitted].

²⁶ See Véronique Ranouil, *La subrogation réelle en droit civil français* (Paris: Librairie générale de droit et de jurisprudence, 1985) at 57-63.

²⁷ This observation was made long ago: see Henri Capitant, “Essai sur la subrogation réelle” (1919) 18 RTD civ 385 at 392. See also Savaux, *supra* note 17, Nos 26, 37.

²⁸ *Ibid* Nos 13, 17.

²⁹ See the discussion in Magdalena Raczynska, “Parallels Between the Civilian Separate Patrimony, Real Subrogation and the Idea of Property in a Trust Fund” in Lionel Smith, ed, *The Worlds of the Trust*, Cambridge University Press [forthcoming in August 2013] 454 at 465-69. Capitant was skeptical of the value of “les vieux brocards des Bartolistes” (*supra* note 27 at 391-93).

³⁰ Another typical example would be a succession before liquidation: in Quebec law, see art 780 CCQ.

Quebec law, mentioned earlier, is that a hypothec on a particular thing extends, if the thing be alienated, to its replacement—or, if there be no replacement, then to the price received.³¹ The price falls into the hypothec of the debtor, just as the original thing did; neither falls into a special universality.

In this paper, no attempt is made to develop a theory of real subrogation. The goal is to answer the question set out earlier: namely, whether the technique could be applied so as to conclude that the proceeds of an unauthorized disposition of trust property should themselves be held to be trust property, regardless of the intention of the trustee and any third party with whom he dealt. It is, however, important to mention that, if real subrogation can operate in this way, it would be an example of real subrogation in universalities. The reason this is important relates to the question mentioned above—that is, whether the possibility of real subrogation depends upon the existence of a disposition of law. Many authors are of the view that it does so depend in the context of particular assets but not in the context of universalities.³²

C. Real Subrogation and the Quebec Trust Patrimony

In his 1919 study, Capitant argued that real subrogation could operate in a number of situations without the need for a legislative disposition. At least two of these deserve attention in the present analysis.

One of them was the case in which a person (A) holds a real right in a thing and another person (B) has alienated the thing in such a way that the real right is lost. The typical example is an instalment sale by A to B, followed by a sale of the thing by B to a third party. A remains the owner of the thing after the instalment sale, but for reasons related to the protection of third parties who rely in good faith on appearances, B may be able to transfer ownership to such a third party.³³ In this kind of case,

³¹ See art 2674, paras 2-3 CCQ.

³² See e.g. Zenati-Castaing & Revet, *supra* note 24 at para 157; Raczyńska, *supra* note 29 at 468. It is unclear, however, whether this distinction can hold. If one takes a wide view of the meaning of universality, then every case of real subrogation may be a case of subrogation in universalities. On this point, see Roderick A Macdonald, "Reconceiving the Symbols of Property: Universalities, Interests and Other Heresies" (1994) 39:4 McGill LJ 761 at 779 (expressing the view that the CCQ implies that there is a division of the patrimony "whenever some property falling within it is not subject to the ordinary rules governing the common pledge of creditors" at 778-79). A division of a patrimony is a kind of universality. This also invites the question whether "patrimonial subrogation" might be a better label than "real subrogation", since the new asset might itself be a personal right.

³³ In Quebec law, publication is required in some instalment sales: see art 1745, para 2 CCQ. Where publication is required and has not been made, A's ownership is not op-

Capitant argued, there should be real subrogation of the price received from the third party for the thing sold, so that A becomes the owner of the price. This was a strong argument, inasmuch as such an example is usually considered to be a case of real subrogation relating to particular assets.³⁴ In that category of case, it is often thought that real subrogation is allowed only where a legislative text exists to support it. And indeed there was such a text, in certain cases, but Capitant argued that real subrogation should be available even without one:

*Il serait inique de refuser à ce propriétaire dépouillé et réduit à la qualité de créancier d'indemnité, le droit de se faire payer par préférence sur le prix dû par l'acquéreur. Il faut donc, ici encore, décider que le prix est subrogé à la chose.*³⁵

His article described how some courts had been willing to go beyond the relevant legislative texts and grant a wider scope, in this context, to real subrogation. What is particularly interesting is that, in subsequent decades, French courts have continued to allow a wide scope to real subrogation in this situation, enabling it to operate beyond the relevant legislative texts.³⁶

This context may seem distant from the law of trusts, but the trustee who unlawfully disposes of trust property is selling property that does not belong to him, without authority, in a way that may allow the buyer to become the owner. In this perspective, the contexts are not wholly dissimilar. If anything, the claim to real subrogation in the trust context should be stronger, because the instalment seller is engaging in a commercial transaction that, on its own terms, will ultimately lead (if all goes well) to the transfer of ownership according to the contract. In the trust context, by contrast, the trustee is not the would-be purchaser of the trust patrimony but only the administrator of it.

posable to third parties. Even if publication is not required, if B's sale was in the ordinary course of business, A may have to reimburse the third party as a precondition to annulment of the sale to him: see art 1714 CCQ.

³⁴ See text following note 30, above. On the other hand, one might say that the issue is whether the price falls into A's patrimony or B's patrimony; in this light, it could be seen as an example of real subrogation in universalities. Again the distinction between the two different kinds of real subrogation may not be sustainable: see *supra* note 32.

³⁵ Capitant, *supra* note 27 at 411.

³⁶ See Vincent Sagaert, "Cour de cassation française, 26 avril 2000: Priority Conflict Between the Seller Under Title Retention and the Assignee of the Resale Claim" (2002) 10:6 ERPL 823 (especially at page 826). See also Zenati-Castaing & Revet, *supra* note 24 (referring to a 1991 decision of a sale of property held in indivision: "*La subrogation réelle est désormais clairement admise comme un principe général ... : décider, sans texte, qu'un prix de vente peut être substitué à la chose n'est-ce pas appliquer un principe général ? N'est-ce pas la mise en œuvre de la thèse de Capitant, selon laquelle le prix doit toujours être subrogé à la chose ?*" at 251 [reference omitted]).

In Quebec, it has been argued that there is no place for real subrogation in the context of instalment sales.³⁷ There are two cases in the Supreme Court of Canada that seem to point in this direction. The more recent of them did not deal with the question of who owned assets but rather with that of whether assets were unseizable.³⁸ The bankrupt held a pension that was unseizable but withdrew the funds and placed them into another kind of plan that was, in principle, seizable and available to his creditors. He argued that real subrogation should apply so that the new asset should be unseizable. The Court's rejection of this argument, however, should not be read as a ruling that there can never be real subrogation without a legislative text. The Court was concerned about the infinite prolongation of unseizability that would result if this characteristic could be projected onto the proceeds of any number of generations of substitution.³⁹ But this concern does not obviously extend to the trust context; on the contrary, one might think that the trust patrimony should be protected wherever possible. Although the Court stated that "investment and re-investment cases are exceptional, and are expressly provided for in the law,"⁴⁰ it would be going too far to conclude that this pronouncement, in the context of the seizability of assets, has implications for the civil law's ability to maintain the integrity of the trust patrimony.

The earlier case was decided under the *Civil Code of Lower Canada*.⁴¹ It is true that the Court said, in a wide pronouncement:

*D'après les principes généraux de la loi de la province de Québec, il n'existe pas de droit réel ou droit de suite sur l'argent ou le prix provenant de l'aliénation d'une chose.*⁴²

It is not clear, however, that this judgment should be seen as foreclosing the possibility of real subrogation in instalment sales generally, still less in relation to trusts. The plaintiff in this case was not a seller who retained ownership; he had transferred security certificates to his broker after having endorsed them in blank to make them negotiable. The account between the plaintiff and the broker was nothing like a trust, not even like an instalment sale; the plaintiff had himself effectively authorized the

³⁷ See Louis Payette, *Les sûretés réelles dans le Code Civil du Québec*, 4th ed (Cowansville, Que: Yvon Blais, 2010) at para 2137.

³⁸ *Poulin v Serge Morency et Associés Inc*, [1999] 3 SCR 351 at paras 35-39, 177 DLR (4th) 283.

³⁹ *Ibid* ("[w]here do we draw the line? Is the property unseizable in perpetuity, regardless of what use is made of the sums declared to be unseizable?" at para 36).

⁴⁰ *Ibid*.

⁴¹ *Grondin v Lefavre (Trustee)*, [1931] SCR 102, (*sub nom Grondin v Lefavre*) [1931] 2 DLR 114 [cited to SCR].

⁴² *Ibid* at 111.

broker to use the securities like money, and the arrangement between them was a running account between debtor and creditor.⁴³ When the broker became insolvent in the stock market crash, the plaintiff should not have been surprised by the decision that he was not allowed to re-characterize the relationship as a kind of deposit, which would have allowed him to claim a right of ownership of the proceeds of his securities. He had authorized the broker to sell his holdings if need be, not as a trustee but on a running account, and this is exactly what had happened.⁴⁴

Be that as it may, we can conclude this part by considering another situation in which Capitant argued that real subrogation could operate without the need for any legislative text:

*La seconde région du domaine de la subrogation réelle comprend les cas où un patrimoine appartenant à une personne se trouve, soit parce que son titulaire est absent, soit parce que, s'agissant d'une succession, le véritable héritier ne s'est pas encore fait connaître, entre les mains d'un possesseur qui a le droit d'en disposer. La subrogation réelle empêchera la confusion entre ce patrimoine et celui du détenteur.*⁴⁵

Of course, Capitant did not mention the trust; and we might now prefer to say “qui a le *pouvoir* d'en disposer.”⁴⁶ But the generic juridical description that he provided seems perfectly to capture the situation of the Quebec trust, in which the trustee, as administrator of the property of another, has powers over the trust property, though it does not belong to him. In the type of situation that he addressed, Capitant noted that, without the operation of real subrogation, the person in control of another's patrimony would be able to deplete that patrimony and reduce its holder to a mere creditor. That is exactly what would happen in the Quebec trust if real subrogation did not operate. Where a trustee misappropriates and spends trust property, the trust patrimony is reduced. The claim for breach of trust is a purely personal claim, which may be worthless if the trustee is insolvent. And in that case, in the absence of real subrogation, the trustee's other creditors would take an unjustifiable benefit: if the price received for trust property should fall into the trustee's personal patrimony, then the assets in that patrimony will have been inappropri-

⁴³ See *ibid* at 105-106.

⁴⁴ The same result applies to this situation under the common law: see Smith, *Tracing*, *supra* note 13 at 100.

⁴⁵ *Supra* note 27 at 407.

⁴⁶ See e.g. Madeleine Cantin Cumyn, “Le pouvoir juridique” (2007) 52:2 McGill LJ 215.

ately increased at the expense of the trust patrimony, simply by the unlawful act of the trustee.⁴⁷

Since 2007, French law has had a *fiducie*.⁴⁸ French authors have suggested that, where trust property is improperly alienated, real subrogation should operate so that the property acquired in exchange falls into the trust patrimony.⁴⁹ The same result should follow in Quebec, where the autonomy of the trust patrimony is much clearer than in France.⁵⁰

Conclusion

The Quebec trust has been structured as a distinct and autonomous legal institution, which offers many measures of supervision and protection for the trust patrimony and the beneficiaries. There seems every reason to think that the principles of real subrogation should operate in cases of unauthorized dispositions of trust property. This would mean that the proceeds of such dispositions would themselves fall into the trust patrimony, regardless of the intentions of the trustee acting in breach of trust, or of the third parties (however innocent) with whom the trustee has dealt. The law itself is competent to decide that such proceeds rightly belong to the trust. If they did not, there would be an unjustifiable windfall to personal creditors of the breaching trustee, at the expense of the trust and its beneficiaries.

⁴⁷ Writing of the Scottish trust, which forms a separate patrimony with the trustee as its titular, George Gretton states that it would be “absurd” if real subrogation did not operate in a case of an unlawful purchase by the trustee using trust property: George L. Gretton, “Constructive Trusts: I” (1997) 1:3 Ed L Rev 281 at 297-98.

⁴⁸ See arts 2011-30 C civ.

⁴⁹ See Zenati-Castaing & Revet, *supra* note 24 at para 278. The authors state that real subrogation also operates in the case of a lawful, authorized disposition of the trust property, although the idea of real subrogation seems not to be necessary in this case: see text following note 26, above. See also Nicolas Borge, “Le fiduciaire responsable (exégèse de l’article 2026 du Code civil) ?”, *Revue Lamy Droit des Affaires* 47 (March 2010) 83 at para 14. Borge also discusses a problem addressed earlier in this paper (see Part I, above), namely whether it is possible to recover original trust property transferred unlawfully to a third party. He concludes that the disposition may, if the third party is not in good faith, be annulled by the beneficiary (Borge, *supra* note 49 at paras 25-27).

⁵⁰ Some provisions of the French *Code civil* reduce the autonomy of the patrimony of the *fiducie*. By article 2025, the settlor of the *fiducie* is personally liable for debts created in its operation if the assets of the *fiducie* are not adequate. By article 2029, the *fiducie* comes to an end when the settlor dies, if he or she is a natural person, or if the trustee is dissolved or disqualified.