

A Contractors Worst Nightmare – The Breach of Trust Claim

Sections 7, 8 and 13 of the *Construction Lien Act* impose significant obligations on owners, contractors, sub-contractors and officers and directors of the above. Some recent caselaw sheds some light into how Courts in Ontario are interpreting the trust provisions of the *Act*.

A recent decision of the Ontario Superior Court may have the effect of broadening the application of the trust obligations prescribed by sections 7 and 8 of the *Act*. In *Maintemp Heating v. Momat Developments and 633227 Ontario Ltd.* the Court discussed when an owner and/or general contractor will be bound by the privity of contract rule effecting breach of trust claims.

In this case Maintemp agreed to supply a heating and air conditioning system to a townhouse project pursuant to a contract it entered into with Momat. Maintemp was led to believe that Momat was the general contractor for the project. The owner of the project was 633227 Ontario Ltd. Maintemp also sued the officers and directors of 633227 Ontario Ltd, namely, Gordon Matas and Jean-Pierre Matas, who were the president and general manager of such company. Jean-Pierre Matas was also the president of Momat. On Momat's behalf, he signed the agreement between Maintemp and Momat.

Maintemp dealt directly with Momat while it completed its work. All money paid to Maintemp and others on account of contract work, overhead and the purchase of the land were paid by cheques drawn on the TD Account of 633227 Ontario Ltd. All cheques required the signatures of the Matas' and the lawyer who had guaranteed the mortgage that provided financing for the project. A dispute developed between Momat and Maintemp. Maintemp had carried out a substantial portion of its work and provided Momat with its final invoice when Momat dismissed Maintemp from the site and retained a new supplier to complete the work. Maintemp then sued for breach of trust.

The Breach of Trust Claim

In respect of personal liability the Judge stated that if there was a breach of trust ruling against 633227 Ontario Ltd., the officers and directors of that company would be liable by virtue of Section 13 of the *Act*. The Judge stated that in normal circumstances there would be an initial onus on the trust beneficiary (sub-contractor) to prove the existence of the trust, with the onus then shifting to the trustee (contractor) to account for payments made out of the trust fund. The Judge went on to find that the management of the company bank account was

“somewhere between abysmal and appalling”. The funds were not segregated and little effort was made to keep records, by way of vouchers, invoices or any other means to explain the payments that were made. The Court held that in a situation where the moneys were blended together in one bank account and one party was acting as both the owner and general contractor there was a higher onus on the trustee.

The Judge also found that it would be very difficult for a trust beneficiary to identify their trust money because of the blending of funds by a trustee. Accordingly, it was held that there was an onus on 633227 Ontario Ltd. to show both that the money in its TD Account was not trust money and that the money paid from that account was paid to benefit the project.

Privity and Liability

The usual rule in breach of trust cases is that a trust claim can only be asserted against a person or entity who you have a contract with. This is known as the privity of contract rule. The Judge in the Maintemp case held however that the normal rule for determining privity of contract did not apply to the within circumstances. Although Maintemp did not contract with 633227 Ontario Ltd., he found that Momat was merely acting as an agent for 633227 Ontario Ltd. in dealing with the subcontractors and executing contracts. No funds were paid directly from Momat. Rather, money flowed directly to whom it was owed from 633227 Ontario Ltd. Accordingly, the reality was that 633227 Ontario Ltd. did have privity of contract with the Maintemp.

The finding that the owner was acting as its own general contractor led to a further finding that payments being made pursuant to the owner's obligations and payments being made pursuant to the contractor's obligations were made from the same account. The Judge ultimately found that 633227 Ontario Ltd. and its officers and directors had committed a breach of trust and were liable to Maintemp.

Liability of Officers and Directors

The recent case of *Baltimore Aircoil v. ESD Industries* gives us some insight as to how Section 13 of the *Construction Lien Act* is being interpreted by the Courts to find directors, officers or persons with effective control of a corporation liable for breach of trust.



In this case Baltimore Aircoil sued ESD Industries Inc. for breach of trust under section 8 of the *Construction Lien Act* and its principal Thomas Brenton for liability under section 13. Baltimore Aircoil was a sub-subcontractor of ESD. ESD diverted money owing to sub-contractors to pay debts and to pay for work done on other projects. ESD was noted in default and the action continued against Brenton personally.

Brenton argued that section 13 did not create a trust as such. He argued that there is no clear language in section 13 that makes officers, directors and persons with effective control of a corporation themselves trustees. What makes these persons liable under this section is the conduct that is described by this section: "(1) every officer or director of a corporation; and (2) any person ... who has effective control of the corporation or its activities, who assents to, or acquiesces in, conduct that he or she knows or reasonably ought to know amounts to a breach of trust by the corporation is liable for the breach of trust." Essentially Brenton argued that Section 13 of the *Act* did not create a new remedy but merely restated the old common law remedy of breach of trust which was a rather difficult to prove.

The Court in this case concluded that section 13 and the common law of constructive trust were not the same. He found that the standard of proof under Section 13 was well below that which was required by the common law. Under Section 13 all that was required was "to demonstrate that a person within the group defined in subsection (a) and (b) [of section 13] has either assented to or acquiesced in conduct that that person knew or reasonably ought to have known, amounts to a breach of trust by the company." He went on to state that the purpose of the section was to create a separate and independent statutory scheme of remedies and not simply to "restate" the common law. Ultimately the Judge found Brenton personally liable for breach of trust under Section 13 of the *Act*.

Conclusion

What lessons can be learned from these cases? In addition to making every effort to carry out the proper management of their records and accounts, owners and contractors should be aware that the mere hiring of a construction manager or agent on a project will not allow them to circumvent their trust obligations. Moreover, a failure to maintain proper records may in of itself be sufficient to satisfy a court that an owner or contractor is in breach of trust. Officers and directors of owners, contractors and sub-contractors must make sure that money flows down the construction ladder properly. If money owing to contractors or sub-contractors is diverted to other projects or used for other purposes, the Courts are more than willing to find officers and directors of these companies personally liable for breach of trust.



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