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Breach of Trust Claims: Current and Proposed Trust Provisions under the Construction Lien Act

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- Lawyers with decades of construction industry experience and expertise
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(assistance of Harvey Asiedu-Akrofi, student-at-law, gratefully acknowledged)



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"Build it, and they will sue."

Overview

1. Proposed Amendments to the *Construction Lien Act*
2. Existing Statutory Construction Trusts:
Sections 7,8 and 9
3. Liability for Breaches of Trust
4. Section 13 Construction Lien Act Provisions

1. “Review” of CLA Trust Provisions

Striking the Balance: Expert Review of Ontario's *Construction Lien Act*

- In February , 2015, Bruce Reynolds and Sharon Vogel (BLG) were retained by the Ministry of the Attorney General to conduct an Expert Review of the *Construction Lien Act*
- The “Review” was made public in September 2016

“Review” of CLA Trust Provisions, cont’d.

Some concerns previously identified with current trust provisions:

- Lack of Clarity
- Unintended Breaches of Trust
 - Co-mingling project funds in single general bank account
 - Implications on trustee insolvency
- Not as robust as New York Model

“Review” of CLA Trust Provisions, cont’d.

Review Recommendations included:

- Trust funds should be deposited in Trustee’s name
- Trustee’s books and records should clearly show allocations to each trust of funds held together in one general account
- Trustees should keep separate books for each trust
- Trustee’s books and records should show articulated particulars, i.e., assets receivable, assets payable, trust funds received, trust payments and transfers

Will CLA be amended in 2017?

Ontario Ministry of the Attorney General:

- Announced March 21, 2017 that Government will introduce legislation:
 - Modernizing the lien and holdback process
 - Introducing rules around prompt payment; and
 - Creating an adjudicative process for resolving disputes.
 - Legislation will not implement a trial project of public sector project trust accounts

2. Existing Statutory Construction Trusts

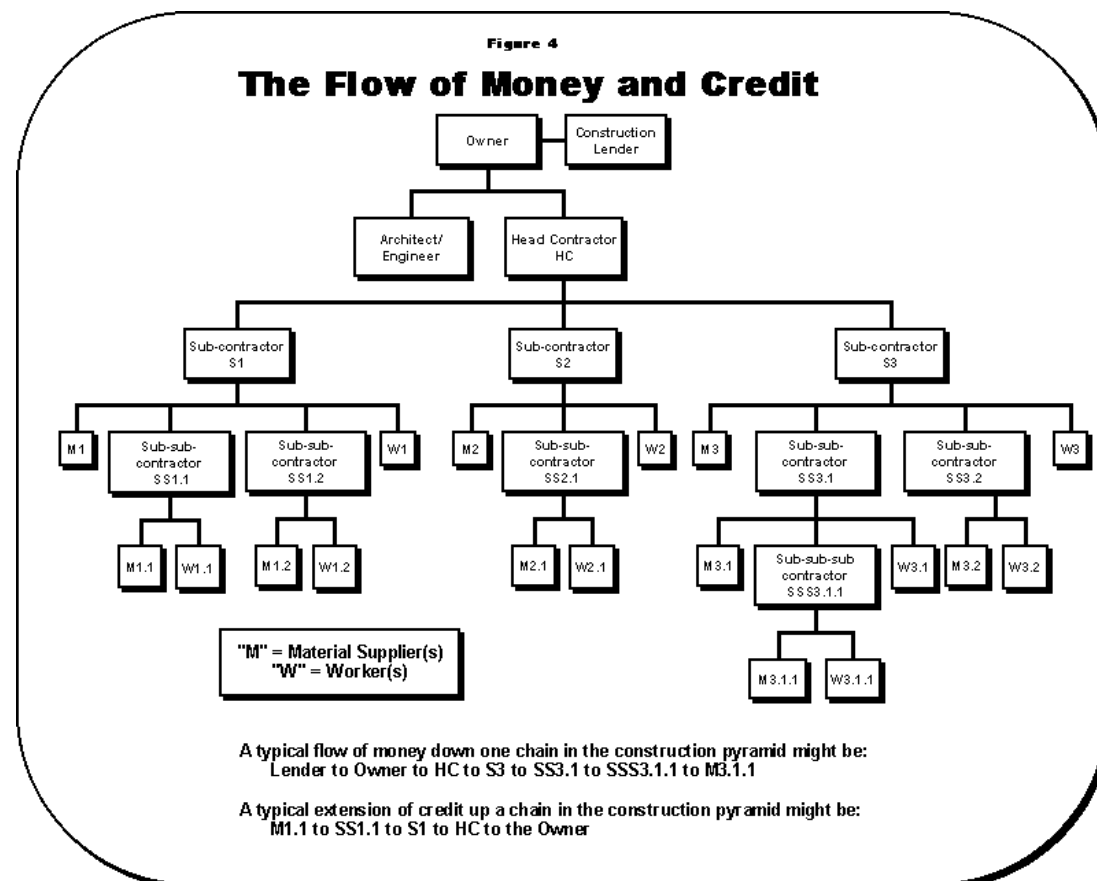
The Ontario *Construction Lien Act* offers two independent statutory remedies:

- Construction Liens
- Statutory Trusts
- These remedies remain



Statutory Construction Trusts, cont'd.

Construction trusts secure the downward flow of money and payments.



Statutory Construction Trusts, cont'd.

Statutory Construction Trusts:

- Ensure payments to contractors and subcontractors
- Make it easy to trace funds
- Shield trust funds from creditors
- Establish proper payment procedures for discharging trusts

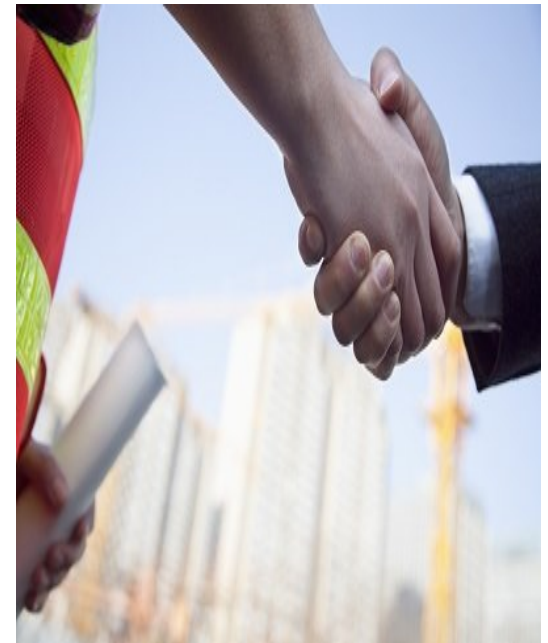
Construction Lien Act (CLA) Trust Provisions

- i. Owner's Trust (Section 7)
- ii. Contractor's and Subcontractor's Trust (Section 8)
- iii. Vendor's Trust (Section 9)
- iv. Managing Trusts (Sections 10 – 12)

i. Owner's Trust

Section 7 of the CLA governs “Amounts received for financing an improvement”.

- Trustee is the Owner. Beneficiary is the Contractor.
- Privity of contract required
- Applies to monies received



Owner's Trust, cont'd.

a. Financing trust (7.1)

- \$ received = \$ used for improvement
- Lender may be “deemed to know” and can be held liable
- Accounts receivable not included

b. Progress certificate trust (7.2)

- “An amount that is equal to an amount so certified”

c. Substantial performance trust (7.3)

- Earned yet unpaid portion of the contract price following substantial completion

ii. Contractor's and Subcontractor's Trust

Section 8 of the CLA governs all amounts owing to the contractor or subcontractor and all amounts received by a contractor or subcontractor.

- Trustees are contractors and/or subcontractors. Beneficiaries are subcontractors and/or suppliers
- Privity of contract required



Contractor's and Subcontractor's Trust, cont'd.

- Applies to monies “owed”
- Beneficiary is not strictly required to prove that supply of goods and materials was intended to be used towards the particular “improvement”

iii. Vendor's Trust

- Section 9 of the CLA protects a contractor's right to seek outstanding payments from owner following a sale of property
- Consideration received by vendor minus reasonable expenses needed to discharge a mortgage is the trust property
- Consideration may be anything of legal value



Vendor's Trust, cont'd.

- Trustee is former owner. Beneficiary is contractor.
- Privity of contract required

iv. Managing Trusts

Statutory trustees must:

- Preserve trust funds until all beneficiaries have been paid
- Pay beneficiaries before paying overhead expenses, e.g., not accounting fees, lawyer fees or other overhead costs
- Maintain separate trust funds per project

Managing Trusts, cont'd.

- Discharge: Section 10 allows a statutory trustee to “discharge” the trust obligation
- Reduction by substitution: Section 11 allows a statutory trustee to “reduce” the trust fund
- Retainage for set off: Section 12 allows a statutory trustee to “retain” trust monies

3. Liability for Breaches of Trust

- Section 13 of the CLA governs liability for breaches of trust
- No element of intent is required
- Joint and several liability is available
- Third-parties can be held liable



Liability for Breaches of Trust, cont'd.

- Any breach of trust under the Construction Lien Act is *prima facie* unreasonable
- A mere failure to account for funds is a breach
- Section 35 of the Trustee Act does not immunize trustees, i.e., acting honestly and reasonably

Breach of Trust and Fraud

- In general, where a breach of trust arises out of fraud, the Ontario Rules of Civil Procedure 25.06(8) apply
- Where a breach of trust arises out of fraud, the *Construction Lien Act* eliminates the need to plead circumstances from which knowledge can be inferred



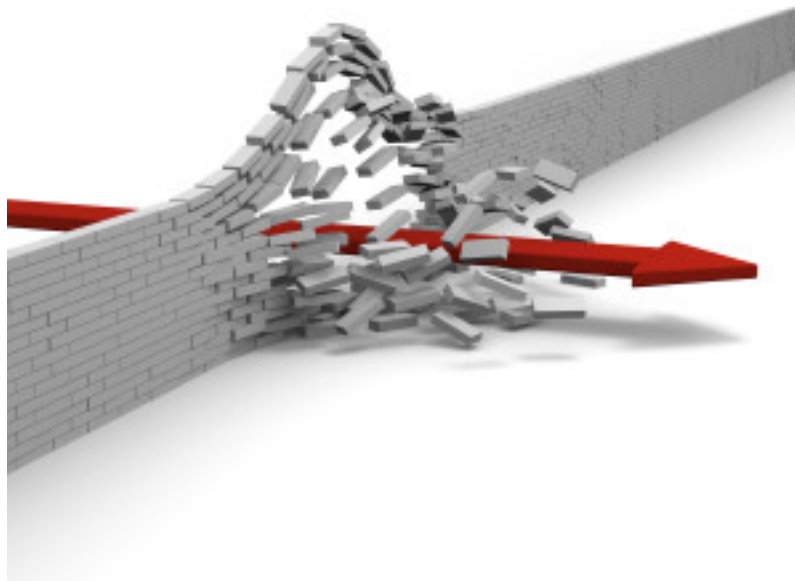
Breach of Trust and Fraud

- Essentially once “trust” established on the evidence, onus shifts to trustee and corporate directors to account for funds



4. Section 13 CLA Liabilities

- Piercing of the corporate veil permitted
- Any person exercising “effective control” of a corporation may be held liable



Section 13 CLA Liabilities, cont'd.

Liability can be extended to:

- Corporate Directors
- Officers
- Employees
- Agents



Some questions to keep in mind...

- i. When does a construction trust arise?
- ii. Can I/they account for funds in/out?
- iii. Where is the trust fund and who has it?
- iv. As a beneficiary, what is my most effective remedy?
- v. Is my trust claim barred by limitations?



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Thank you...



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