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

Andrew J. Heal
Heal & Co. LLP[1]

[1] LL.M., (Osgoode), J.D. (University of Toronto), B.A. (Hons) (McGill University). Past Chair OBA Construction Section, Treasurer, CBA National Construction Section, Partner Heal & CO. LLP, Toronto. The author gratefully acknowledges the assistance of Harvey Asiedu-Akrofi of Heal & Co. LLP in the preparation of this paper, and the work of the 2016 *Ontario Construction Lien Act Review.* A version of this paper was presented at the ACFI 2017 Annual Fraud Conference on May 2, 2017.

# I. INTRODUCTION

This paper highlights some of the current trust provisions under Part II of the Ontario *Construction Lien Act*[2] (**"Act or CLA"**) alongside a number of recommended changes reflected in the recently delivered *Review*.

In April 2016, *Striking the Balance: Expert Review of Ontario's Construction Lien Act (the* **"Review"***)*[3] was delivered. After hearing from and meeting with many industry stakeholders, and after soliciting input from industry associations, owners, lenders, sureties and other industry groups, the *Review* provided the Ontario government with one hundred recommendations collected from approximately 550 pages of thoughtful analysis all to help modernize the *Act*. This paper focuses on Chapter Seven of the *Review*: Construction Trusts.

In sum, the *Review* identified and summarized the tensions and competing issues reflected in several rounds of discussion concerning various non-technical issues. It attempted to "strike a balance."[4] While initially spurred on by industry concerns about promptness of payment, a consensus emerged in the *Review* about three core issues that should be addressed in amendments made to the *Act*: modernizing the lien/holdback regime, introducing a promptness of payment regime and introducing targeted adjudication. What may be left out, and we will see in the summer and fall of 2017, is any modernization of the *Act's* construction trust provisions.

In light of the *Review* and its recommendations to modify construction trust laws, Part I of this paper will introduce the history and purpose of construction trusts in Ontario. It describes the evolution of construction trust legislation and examines the underlying rationale for statutory trust rights.

Part II of this paper discusses breach of trust proceedings in Ontario. It outlines the manner by which a trust claim must be pled and describes the extent to which personal liability can result from a breach of trust. In addition, the paper briefly reviews select recommendations from the *Review*,[5] including the joinder of trust and lien claims in the same legal proceeding.

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[2] R.S.O. 1990, c. C.30.

[3] Bruce Reynolds and Sharon Vogel, *Report prepared for the Ministry of the Attorney General and the Ministry of Economic Development, Employment and Infrastructure*, April 30, 2016 (published September 2016):https://www.attorneygeneral.jus.gov.on.ca/english/about/pubs/cla_report/#_Promptness_of_Payment There were many written submissions and stakeholder meetings, the details of which are summarized in the report, copies of which can be found at the *Review* website: http://www.constructionlienactreview.com.

[4] The *Review* considered the most fundamental tension to be that of regulation versus freedom of contract. Lastly, the one "fundamental recommendation" was to reflect the breadth and scope of changes in a new Act: the "*Construction Act: An Act respecting Security of Payment and Efficient Dispute Resolution in the Construction Industry*."

[5] On March 21, 2017, the Ministry of the Attorney General further announced that draft legislation was underway to modernize the *CLA* in three areas: (1) modernizing the lien and holdback process, (2) introducing rules around prompt payment, and (3) creating an adjudicative process for resolving disputes. Specifically excluded was the pilot project of "project trust accounts" for selected construction projects.

Part III of this paper reviews defences to a breach of trust claim and the corresponding approach taken in New York State.

Part IV of this paper offers some concluding thoughts and comments.

## A. History and Purpose of the Ontario Construction Trust

> "[C]onstruction lien trusts *are* unique. They exist by statute at each level of the contract pyramid for the benefit of those adding value to the land involved. The trust imposed on owner, contractor, and subcontractors is for the benefit of all those on the next level in the pyramid below the trustee. Each trustee will have entered into a contract, oral or written, with the beneficiary of the trust. The statute has super-imposed a trust on each contract. The contractor in this case would be liable in contract to its subcontractor for the full amount of the contract, regardless of the amount of his own overhead costs. … To compare this very specific statutory trust with more usual types of trusts is inappropriate, and does not assist in understanding its unique nature."[6]

There are a number of provincially created statutory trusts. In Ontario, construction trust legislation was introduced in 1942.[7] Section 21 of *The Statute Law Amendment Act*, 1942 codified construction trusts under section 3(1) of the then *Mechanics' Lien Act*.[8] It read:

> "All sums received by a builder or contractor or a subcontractor on account of the contract price shall be and constitute a trust fund in the hands of the builder or contractor, or of the subcontractor, as the case may be, for the benefit of the proprietor, builder or contractor, subcontractors, Workmen's Compensation Board, workmen and persons who have supplied material on account of the contract, and the builder or contractor or the subcontractor, as the case may be, shall be the trustee of all such sums so received by him, and until all workmen and all persons who have supplied material on the contract and all sub-contractors are paid for work done or material supplied on the contract and the Workmen's Compensation Board is paid any assessment with respect thereto, may not appropriate or convert any part thereof to his own use or to any use not authorized by the trust."[9]

Following several amendments, section 3(1) of *The Mechanics' Lien Act* progressively evolved into the current Ontario *Construction Lien Act*, *1990*.[10] Despite their differences, each provincial construction trust statute is vulnerable to the contest between the federally mandated *Bankruptcy and Insolvency Act*[11] (**"BIA"**) regime, the *Companies*

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[6] *Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd.* (1999), 45 C.L.R. (2d) 178 (Ont. C.A.) at para 11.
[7] Duncan W. Glaholt & Markus Rotterdam, "Managing Trust Funds; The New York Model" (2003) 21 C.L.R. (3d) 74.
[8] *T. McAvity & Sons Ltd. v. Canadian Bank of Commerce*, [1959] S.C.R. 478 (S.C.C.) at para 11.
[9] *Ibid.* at para 2 (citing s. 3 of *The Mechanics' Lien Act*, R.S.O. 1950 c. 227).
[10] *Construction Lien Act*, R.S.O. 1990, c. C.30
[11] R.S.C. 1985, c. B-3.

*Creditors' Arrangement Act*[12] (**"CCAA"**) regime and respective provincial schemes of distribution that arise out of failed construction projects.

### 1. *Common Law and Statutory Trusts*

To establish some insight into the relationship between provincial construction trusts and federal bankruptcy and insolvency schemes, it is necessary to recognize the common law elements of a trust. They are: (a) certainty of intention; (b) certainty of subject matter; and (c) certainty of object(s).

Once a trust is confirmed to exist, the *CLA* can impose liability well beyond the trustee, up to its directing minds, to those who receive the trust funds, as well as to those in control of the corporate trustee. As deemed trusts, construction trusts can be distinguished from common law trusts by "the degree of knowledge required to find liability".[13] Likewise, statutory construction trusts include the ability to "trace funds into the hands of strangers to the trust".[14]

### 2. *Provincial Construction Trusts and Canadian Bankruptcy and Insolvency Laws*

The *Review* identified a number of tensions that have emerged and which relate to the current construction trust provisions of the *Act*.[15] These included the following:

i. When there is an insolvency or bankruptcy,[16] federal paramountcy doctrine can result in trust claims being treated like other unsecured claims such that opportunities for recovery are limited;
ii. There are *BIA* and *CCAA* stay provisions (either by statute or in interim court orders) that can prevent lien and trust claimants from commencing actions without court approval (and risk limitations problems);
iii. The Canada Revenue Agency has section 224 super-priority for unpaid source deductions and the super-priority of post-filing DIP financing or interim receiver's financing.

The *CLA* is provincial legislation subject to the federal paramountcy doctrine. As a result, in the case of an operational conflict, the *BIA* and *CCAA* will prevail. Under section 67(1) *BIA*, for example, property "held by the bankrupt in trust for any other person" is not available to creditors of the bankrupt/insolvent. Although provincial law governs the creation of trusts, federal law governs the categorization of claims for purposes of relative priority. Subject to the federal law, provincial statutory trusts can *only* be exempt from

[12] R.S.C. 1985, c. C-36.
[13] *Review*, (citing David Bristow et al, Construction Builders' and Mechanics' Liens in Canada, 7th ed., loose-leaf (Toronto: Carswell, 2005) at 9-6.
[14] Duncan Glaholt, Conduct of a Trust Action (Toronto: Carswell, 2011) at 3.
[15] *Review*, page 115.
[16] The federal legislative regimes are the *Bankruptcy and Insolvency Act* ("*BIA*") or *the Companies Creditors Arrangements Act* ("*CCAA*").

forming part of the bankrupt/insolvent person's estate if the trust bears the attributes of a common law trust.[17]

As a practical matter, the Alberta Court of Appeal recently described the overlap between trusts and insolvency in plain terms:[18]

> "Obviously, if everyone is solvent, nobody cares about trusts, secured interests or priorities. If everyone is solvent, nobody cares about builder's liens either".

There is no uniformity in provincial construction trust regimes across Canada. Ontario and Manitoba, for example, have trust provisions but do not require separate project trust accounts. By contrast, BC and Saskatchewan have statutory requirements for separate holdback accounts. BC requires private (not public) owners to keep a separate account for each contract. Saskatchewan requires joint project trust accounts but permits mixed trust accounts, like lawyers' trust accounts.[19]

In the initial Draft 1983 *Act* and accompanying Discussion Paper on the Draft *Act*, joint trust accounts were under recommendation. In the subsequent Report of the Attorney General's Advisory Committee on the Draft *Construction Lien Act*, project trust accounts were cited as "the most controversial proposal"[20]. On the subject of trust accounts, the *Review* identified "certainty of subject matter" and the tracing of construction funds through receipt into a trust account to be perhaps the most pressing issue.

The *Act* currently identifies the trustees of each current statutory trust described below (owner, contractor and subcontractor, vendor). To best manage the trust, the *Review* recommended that Ontario follow aspects of the *New York Lien Law*. Recommendations included:

i. Require funds be deposited in the trustee's name;
ii. Do not require separate bank accounts for separate trusts, but do require sufficient books and records of account to clearly show the allocation of each trust;
iii. Require separate books of account for each trust showing deposits and withdrawals;
iv. Require books and records to be sufficiently particular: including assets receivable, assets payable, trust funds received and trust payments made with trust assets, and

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[17] *Review*, page 119, and ff.
[18] *Iona Contractors Ltd. v. Guarantee Company,* 2015 ABCA 240, (4th) 165 (Alta C.A.); leave to appeal to refused *Ernst & Young Inc. v. Guarantee Co. of North America*, 2016 CarswellAlta 660, 2016 Carswell Alta 661 (S.C.C.).
[19] The *Review* points out that the co-mingling problem still exists among beneficiaries and layers of beneficiaries to a construction trust but as long as the funds are not co-mingled in a general account the trust funds can still be identified. See *Review,* page 149, and *Law Society of Upper Canada v. Toronto Dominion Bank* (1998), 169 D.L.R. (4th) 353 (Ont. C.A.); leave to appeal refused *Law Society of Upper Canada v. Toronto Dominion Bank* (1999), 250 N.R. 194 (note) (S.C.C.) where the earmarked identity for separate clients is lost. A separate project trust account is distinct from the apparent BC model. The *Review* also reported that many owners do not comply with the statutory requirement of separate project trust accounts in BC and Saskatchewan, and that the contractor beneficiaries are reluctant to complain particularly where they are being paid on an ongoing basis, but for the holdback.
[20] *Review*, page 128.

any transfers for the purposes of the trust.[21]

The *Review* ultimately proposed that a separate bank account called a "project trust account" or "project bank account" would be the best mechanism to segregate trust funds. In addition, it recommended a two-year pilot project be initiated for certain public sector projects, to study the operation and effects of such separate trust accounts.[22]

### 3. *Provincial Construction Trusts and Canadian Bankruptcy and Insolvency Laws: The Law*

In Canada, the *BIA* and the *CCAA* govern bankrupt and insolvent entities. In the event of an operational conflict with provincial law, the doctrine of paramountcy means the federal statute "trumps". The engagement between statutory trusts and federal bankruptcy has an immediate impact where provincial legislation interacts with federal bankruptcy law (i.e., somebody is insolvent).

In 2015, the Alberta Court of Appeal, in *Iona Contractors Ltd. v. Guarantee Company* (**"Iona"**),[23] was asked to reconcile the overlap between the *BIA* and holdback funds that remained unpaid under a construction contract. In its decision, the appellate court summarized the relationship between trusts and bankruptcy. It wrote:

> "The categorization of a claim for the purposes of relative priority is a matter of federal law. Thus, the provinces cannot define what is a 'trust' or a 'secured party' for the purposes of bankruptcy law; which claims are included in those various categories is a matter of federal law. This ensures the uniformity of bankruptcy law across Canada.
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> But while uniformity of bankruptcy law is an important value, that does not mean that results will not vary from province to province. Since 'property and civil rights' can vary depending on provincial law, a type of creditor in one province may be in a different position after bankruptcy than the same type of creditor in another province."[24]

In effect, "[w]hether any provincial scheme is in operational conflict with the bankruptcy regime must be determined by examining the purposes and effect of the provincial legislation within its statutory context."[25]

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[21] *Review*, page 148.
[22] *Review*, page 149. During the consultation process, the *Review* recognized that municipalities and other public bodies were opposed to either mandatory trust accounts or separate bank accounts both for the administrative cost, and for problems in exercising rights of set off. Review, page 144.
[23] *Iona Contractors Ltd. (Receiver of) v. Guarantee Co. of North America*, 2015 ABCA 240, 44 C.L.R. (4th) 165 (Alta. C.A.); leave to appeal refused *Ernst & Young Inc. v. Guarantee Co. of North America*, 2016 CarswellAlta 660, 2016 CarswellAlta 661 (S.C.C.)
[24] *Ibid*. at para 26.
[25] *Ibid.* at para 31.

On the issue of trusts and priority of creditor claims, the court further explained:

> "An important consideration is that these trust provisions do not directly, intentionally, or primarily affect the order of payment in bankruptcy. They are part of a larger statutory scheme designed to create new civil rights for unpaid subcontractors. The holdback provisions and the trust provisions play a supportive role in the overall regime, and are primarily in place to prevent the unjustified erosion of the lien rights created by the statute. There is no attempt to use 'form to override substance'; the trust is a legitimate part of the overall scheme. However, [the Supreme Court of Canada in] *Husky Oil* confirms that an intention to reorder priorities is not necessary to create an operational conflict."[26]

In the end, the appellate court concluded that there was no operational conflict between the provincial legislation that created the holdback trust and the federal *BIA* because the statutory trust met all the requirements of a common law trust. In addition, the trust clearly existed before the contractor went bankrupt. Likewise, the trust funds were quantified and traceable into the hands of the owner since it had previously segregated them into a separate account.

In sum, the Court held:

> "There is no deliberate attempt to reorder priorities in bankruptcy, and the province is not attempting to achieve indirectly what it cannot do directly. These considerations, coupled with the fact that the trust provisions … are merely a collateral part of a complex regime designed to create security for unpaid subcontractors, leads to the conclusion that there is no operational conflict."[27]

After *Iona*, the Supreme Court of Canada denied leave to appeal, arguably making the Alberta decision the governing ruling on the relationship between provincial statutory trusts and federal bankruptcy and insolvency laws in Canada.

## B. Statutory Trusts: A Description

Part II of the *CLA* sets out the rules governing trusts. Sections 7 through 9 govern the creation of specific trusts.

### 1. *Section 7: Owner's Trust*

Section 7 *CLA* governs "amounts received by an owner for financing a trust". It imposes upon an owner a trust over funds either received or deemed to have been received and directed towards financing an improvement. Section 7(1) reads:

[26] *Ibid.* at para 33.
[27] *Ibid.* at para 37.

> (1) All amounts received by an owner, other than the Crown or a municipality, that are to be used in the financing of the improvement, including any amount that is to be used in the payment of the purchase price of the land and the payment of prior encumbrances, constitute, subject to the payment of the purchase price of the land and prior encumbrances, a trust fund for the benefit of the contractor.

Likewise, ss. 7(2) and 7(3) create "certificate trusts" that extend to funds acquired post-improvement.

> (2) Where amounts become payable under a contract to a contractor by the owner on a certificate of a payment certifier, an amount that is equal to an amount so certified that is in the owner's hands or received by the owner at any time thereafter constitutes a trust fund for the benefit of the contractor.
>
> (3) Where the substantial performance of a contract has been certified, or has been declared by the court, an amount that is equal to the unpaid price of the substantially performed portion of the contract that is in the owner's hands or is received by the owner at any time thereafter constitutes a trust fund for the benefit of the contractor.
>
> (4) The owner is the trustee of the trust fund created by subsection (1), (2) or (3), and the owner shall not appropriate or convert any part of a fund to the owner's own use or to any use inconsistent with the trust until the contractor is paid all amounts related to the improvement owed to the contractor by the owner.[28]

2. *Section 8: Contractor's and subcontractor's trust*

Section 8 *CLA* governs amounts owing or received by a contractor or subcontractors. It creates a trust over funds owed to contractors and subcontractors needless of whether payment is immediate or past due. Section 8 reads:

> (1) All amounts, (a) owing to a contractor or subcontractor, whether or not due or payable; or (b) received by a contractor or subcontractor, on account of the contract or subcontract price of an improvement constitute a trust fund for the benefit of the subcontractors and other persons who have supplied services or materials to the improvement who are owed amounts by the contractor or subcontractor.
>
> (2) The contractor or subcontractor is the trustee of the trust fund created by subsection (1) and the contractor or subcontractor shall not appropriate or convert any part of the fund to the contractor's or subcontractor's own use or to any use inconsistent with the trust until all subcontractors and other persons who supply services or materials to the improvement are paid all amounts related to the improvement owed to them by the contractor or subcontractor.[29]

[28] R.S.O. 1990, c. C.30, s.7.
[29] R.S.O. 1990, c. C.30, s.8.

> In *Sunview Doors Ltd. v. Academy Doors & Windows Ltd.,*[30] the Ontario Court of Appeal clarified the manner by which a trust exists under s. 8. On the facts, the Plaintiff, Sunview, was a supplier of custom-made doors. Sunview supplied the Defendant, Academy, with doors for a particular job. Despite efforts, Sunview was never informed of the specific jobsite. This fact was critical to the dispute because for a lien to arise in Ontario, supply of services or materials for a particular improvement must be known and intended. Nevertheless, Academy soon experienced financial difficulties that prevented the company from paying Sunview. Sunview sued for unpaid accounts and breach of trust under ss.8 and 13 of the *CLA*.

Sunview's initial attempt to pursue a section 8 *CLA* claim was barred because it was unable to prove that "at the time it sold or supplied its doors to Academy, it *intended* that they be used for known and identified improvements."[31] Sunview appealed.

On appeal, the "intended" requirement established earlier under *Central Supply Co. (1972) Ltd. v. Modern Tile Supply Co.*[32] was scrutinized by the appellate court. It concluded that to benefit from the s. 8 *CLA* trust, Sunview was not required to satisfy the prevailing "intended" requirement provided that there was some *link* to the improvement in question. It wrote:

> "The reference in s. 8(1) to the creation of a trust fund for the benefit of 'persons who have supplied services or materials to *the* improvement' generally requires that a link be made between the materials supplied and the improvement (emphasis added). However, nothing in the wording of the section requires that the supplier intend that the material be incorporated into a known and specific improvement at the time of sale or supply and I would not read this requirement into s. 8(1). Provided that the supplier is able to link the material to the improvement for which the subcontractor was owed money or has been paid, the supplier will be entitled to the benefit of the s.8 statutory trust in the Act. … This interpretation best promotes the purpose of the section and the object of the Act. The purpose of s. 8 is to impress money owing to or received by contractors or subcontractors with a statutory trust, a form of security, to ensure payment of suppliers. The object of the Act is to prevent unjust enrichment of those higher up in the construction pyramid by ensuring that money paid for an improvement flows down to those at the bottom."[33]

### 3. *Section 9: Vendor's Trust*

Section 9 imposes a trust over proceeds earned by a former owner through the sale of an interest in property when a contractor remains unpaid. Section 9 reads:

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[30] *Sunview Doors Ltd. v. Academy Doors & Windows Ltd.*, 2010 ONCA 198, 87 C.L.R. (3d) 163 (Ont. C.A.) [*Sunview Doors*].
[31] *Ibid.* at para 15.
[32] *Central Supply Co. (1972) Ltd. v. Modern Tile Supply Co.*, (2001), 55 O.R. (3d) 783, 11 C.L.R. (3d) 1 (Ont. C.A.)
[33] *Sunview Doors,* at para 23.

> (1) Where the owner's interest in a premises is sold by the owner, an amount equal to, (a) the value of the consideration received by the owner as a result of the sale, less, (b) the reasonable expenses arising from the sale and the amount, if any, paid by the vendor to discharge any existing mortgage indebtedness on the premises, constitutes a trust fund for the benefit of the contractor.
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> (2) The former owner is the trustee of the trust created by subsection (1), and shall not appropriate or convert any part of the trust property to the former owner's own use or to any use inconsistent with the trust until the contractor is paid all amounts owed to the contractor that relate to the improvement.[34]

Sections 10, 11 and 12 concern the proper administration and reduction of trust funds. Section 10, in particular, is subject to insolvency provisions included under s. 85 of the *Act*.[35] Sections 10 through 12 read as follows:

> **Payment discharging trust**
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> 10. Subject to Part IV (holdbacks), every payment by a trustee to a person the trustee is liable to pay for services or materials supplied to the improvement discharges the trust of the trustee making the payment and the trustee's obligations and liability as trustee to all beneficiaries of the trust to the extent of the payment made by the trustee.[36]
>
> **Where trust funds may be reduced**
>
> 11. (1) Subject to Part IV, a trustee who pays in whole or in part for the supply of services or materials to an improvement out of money that is not subject to a trust under this Part may retain from trust funds an amount equal to that paid by the trustee without being in breach of the trust.[37]
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> **Application of trust funds to discharge loan**
>
> (2) Subject to Part IV, where a trustee pays in whole or in part for the supply of services or materials to an improvement out of money that is loaned to the trustee, trust funds may be applied to discharge the loan to the extent that the lender's money was so used by the trustee, and the application of trust money does not constitute a breach of the trust.[38]
>
> **Set-off by trustee**
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> 12. Subject to Part IV, a trustee may, without being in breach of trust, retain from trust funds an amount that, as between the trustee and the person the trustee is liable to pay under a contract or subcontract related to the improvement, is

[34] R.S.O. 1990, c. C.30, s. 9.
[35] See R.S.O. 1990, c. C.30, s. 85.
[36] R.S.O. 1990, c. C.30, s. 10.
[37] R.S.O. 1990, c. C.30, s. 11 (1).
[38] R.S.O. 1990, c. C.30, s. 11 (2).

> equal to the balance in the trustee's favour of all outstanding debts, claims or damages, whether or not related to the improvement.[39]

Lastly, in the event of any uncertainty concerning the existence of a trust, s. 66 offers prospective trustees permission to seek court direction by way of application. Section 66 reads:

> "Where a person is in possession of an amount that may be subject to a trust under Part II, the person may apply to the court for direction and the court may give any direction or make any order that the court considers appropriate in the circumstances."[40]

## C. Trust Rights When No Lien Rights Exist

In 1955, the Supreme Court of Canada (**"SCC"**) confirmed in *Minneapolis-Honeywell Regulator Co. v. Irvine & Reeves Ltd. (**"Minneapolis v. Empire"**)* that trust beneficiaries can rely exclusively upon trust rights without preceding with a lien claim.

*Minneapolis v. Empire* arose over a dispute concerning the installation of heating plants in four British Columbia public schools. Minneapolis-Honeywell Regulator Co. (**"Minneapolis"**) was hired as a subcontractor under an agreement to supply and install automatic controls for heating systems. Empire Brass Mfg. Co. Ltd. (**"Empire Brass"**) was a wholesaler that provided the necessary plumbing and heating equipment. Irvine and Reeves Ltd (**"I&R"**) was the main contractor for the project.

I&R owed Empire Brass approximately $20,000 for current and past work. To cover its debts, I&R assigned to Empire Brass its book accounts. I&R ultimately went into liquidation forcing Empire Brass to pursue its rights in court.

In British Columbia, The *Mechanics' Lien Act* governed the administration of construction trusts. In relevant part, s. 19 read:

> "All sums received by a contractor or a sub-contractor on account of the contract price shall be and constitute a trust fund in the hands of the contractor or of the sub-contractor, as the case may be, for the benefit of the owner, contractor, sub-contractors, Workmen's Compensation Board, labourers, and persons who have supplied material on account of the contract; and the contractor or the sub-contractor, as the case may be, shall be the trustee of all such sums so received by him, and, until all labourers and all persons who have supplied material on the contract and all sub-contractors are paid for work done or material supplied on the contract and the Workmen's Compensation Board is paid any assessment with respect thereto, shall not appropriate or convert any part thereof to his own use or to any use not authorized by the trust.[41]

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[39] R.S.O. 1990, c. C.30, s. 12.
[40] R.S.O. 1990, c. C.30, s. 66.
[41] *Minneapolis-Honeywell Regulator Co. v. Irvine & Reeves Ltd.*, [1955] S.C.R. 694 (S.C.C.) at para 1 (*citing* British Columbia *Mechanics' Lien Act*, R.S.B.C. 1948, c. 205, s. 19).

In reversing the trial court decision, the appellate court concluded that for Empire Brass to exercise its trusts rights under s. 19, it was necessary to have in place a proper lien claim, to which it did not. Empire Brass appealed.

The appeal to the SCC was advanced on grounds that the appellate court misinterpreted s. 19. Writing for the SCC, Locke J. concluded that construction trust rights were created and enforceable independent of lien rights. He wrote:

> "I find no ambiguity in the language of s. 19 and, while the adding of this additional protection for the interests of labourers and material men may create difficulties for contractors seeking credit, … and while the section lacks any direction as to the manner in which the trust fund declared is to be apportioned among those entitled, these considerations do not, in my opinion, afford any sufficient reason for failing to give effect to the plain meaning of the language employed or to read into the section a provision that the rights given may be exercised only by those who then have a right to a lien upon the work."[42]

Following *Minneapolis v. Empire*, Ontario courts have since expressed that *CLA* trust provisions give rise solely to personal rights and are ineffective in forming a claim to an interest in land.[43]

60 years later, the SCC, in *Stuart Olson v. Structal Heavy Steel* (**"Stuart Olson"**),[44] reaffirmed the rule in *Minneapolis v. Empire*. In *Stuart Olson*, a contractor paid into court the full amount claimed as owing by a subcontractor. The purpose was to vacate the subcontractor's lien. In light of the rule in *Minneapolis v. Empire*, the Court declined to accept the argument that payment into court extinguished outstanding trust claims. In addition, although the Court did acknowledge that when exercised simultaneously with a lien remedy, a trust remedy does not and should not lead to a claimant being "paid twice", it suggested that had cash rather than a lien bond been posted, the outcome may have been different.

In some western provinces, local courts have recently refused to allow a trustee or person in the construction pyramid to post a lien bond as security for a lien. The general refusal reflects the suggestion made in *Stuart Olsen* that to extinguish a trust obligation, cash must be posted to vacate a lien. This appears to be the interpretation that some provincial court registrars have adopted from the SCC's holding that "[t]he filing of a lien bond has no effect on the existence and application of the trust remedy".[45]

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[42] *Ibid.* at para 24.
[43] *Rafat General Contractor Inc. v 1015734 Ontario Ltd.*, (2005), 52 C.L.R. (3d) 63 (Ont. S.C.J.) at para 8.
[44] *Stuart Olson Dominion Construction Ltd. v. Structal Heavy Steel* [2015] 3 S.C.R. 127, 44 C.L.R. (4th) 1 (S.C.C).
[45] *Ibid.* at para 39.

## II. BREACH OF TRUST PROCEEDINGS

### A. Pleading Breach of Trust

#### 1. *Damages*

In general, damages for a claim of breach of trust may be calculated as the actual loss to the trust caused by alleged acts and omissions.[46]

#### 2. *Claims for Tracing Accounting*

To support a claim for damages, statutory construction trusts are enhanced by their predisposition for being "traced". Tracing is a necessary step towards securing a remedy for a breach of trust under the *Act*. In the construction context, the procedure is applied as a tool grounded in equity.

In *Citadel General Assurance Co. v. Lloyds Bank Canada*,[47] the SCC distinguished tracing at common law from tracing in equity. It wrote:

> "Tracing at law does not depend upon the establishment of an initial fiduciary relationship. Liability depends upon receipt by the defendant of the plaintiff's money and the extent of the liability depends on the amount received. Since liability depends upon receipt the fact that a recipient has not retained the asset is irrelevant. For the same reason dishonesty or lack of inquiry on the part of the recipient are irrelevant. Identification in the defendant's hands of the plaintiff's asset is, however, necessary. It must be shown that the money received by the defendant was the money of the plaintiff. Further, the very limited common law remedies make it difficult to follow at law into mixed funds…. Both common law and equity accepted the right of the true owner to trace his property into the hands of others while it was in an identifiable form. The common law treated property as identified if it had not been mixed with other property. Equity, on the other hand, will follow money into a mixed fund and charge the fund."[48]

In Ontario, tracing for an accounting is executed by referral to a referee under Rule 54 of the *Rules of Civil Procedure*.[49] Rule 55.04 refers specifically to a reference for the taking of accounts. It states:

> (1) On the taking of accounts, the referee may, (a) take the accounts with rests or otherwise; (b) take account of money received or that might have been received but for wilful neglect or default; (c) make allowance for occupation rent and determine the amount; (d) take into account necessary repairs, lasting

[46] *Fales v. Canada Permanent Trust Co.* (1976), [1977] 2 S.C.R. 302 (S.C.C.) at para 42.
[47] *Citadel General Assurance Co. v. Lloyds Bank Canada,* [1997] 3 S.C.R. 805 (S.C.C.).
[48] *Ibid.* at para 57.
[49] R.R.O. 1990, Reg. 194, r. 54.02 (2).

> improvements, costs and other expenses properly incurred; and (e) make all just allowances.[50]

3. *The Oppression Remedy*

In the event that a corporation or its directors engage in oppressive acts that harm the legal and equitable interests of a corporation's necessary stakeholders, s. 248 of the *Ontario Business Corporations Act* offers an oppression remedy.

Under s. 248,

> (1) A complainant . . . may apply to the court for an order under this section. (2) Where, upon an application under subsection (1), the court is satisfied that in respect of a corporation . . .(a) any act or omission of the corporation . . . effects or threatens to effect a result; (b) the business or affairs of the corporation . . . have been or are threatened to be carried on or conducted in a manner; or (c) the powers of the directors of the corporation . . . are, have been or are threatened to be exercised in a manner, that is oppressive or unfairly prejudicial to or that unfairly disregards the interests of any security holder, creditor, director or officer of the corporation, the court may make an order to rectify the matters complained of. (3) In connection with an application under this section, the court may make any interim or final order it thinks fit including, without limiting the generality of the foregoing,…(j) an order compensating an aggrieved person . . . .

The remedy has been applied in construction disputes concerning allegations of breach of trust.[51]

4. *Onus of Proof*

In general, a plaintiff bears the onus of proof in breach of trust claims. In a s. 8 claim, for example:

> "[T]here is an initial onus on the plaintiff to prove the existence of a trust …. In order to discharge that onus …, the plaintiff would need to show that [the defendant] received monies on account of its contract price for a particular project, that the plaintiff supplied materials on that project and that the [defendant] owes money to the plaintiff for those materials."[52]

Once the onus has been discharged, the burden shifts to the defendant to show that trust funds were properly paid to the beneficiaries.[53]

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[50] R.R.O. 1990, Reg. 194, r. 55.04 (1).
[51] See *S.E. Rozell & Sons Inc. v. Groff* (2000), 2 C.L.R. (3d) 58 (Ont. S.C.J.).
[52] *St. Mary's Cement Corp. v. Construc Ltd.* (1997), 33 C.L.R. (2d) 234 (Ont. Gen. Div.) at para 11.
[53] *Forest City Fire Protection Ltd. v 1099516 Ontario Inc.*, 2015 ONSC 2346, 49 C.L.R. (4th) 163 (Ont. S.C.J.) at para 31.

## B. Personal Liability of the Officer, Directors and Persons-in-Control

Section 13 deals solely with an individual's personal liability for breach of trust by a corporation. The *Act* sets out the extent to which directors, officers and others may be held personally liable but does not recognize those individuals as trustees.[54] Rather, liability established under section 13 turns on a standard of reasonableness.[55] It reads:

> (1) In addition to the persons who are otherwise liable in an action for breach of trust under this Part, (a) every director or officer of a corporation; and (b) any person, including an employee or agent of the corporation, who has effective control of a corporation or its relevant activities, who assents to, or acquiesces in, conduct that he or she knows or reasonably ought to know amounts to breach of trust by the corporation is liable for the breach of trust.
>
> (2) The question of whether a person has effective control of a corporation or its relevant activities is one of fact and in determining this the court may disregard the form of any transaction and the separate corporate existence of any participant.
>
> (3) Where more than one person is found liable or has admitted liability for a particular breach of trust under this Part, those persons are jointly and severally liable.
>
> (4) A person who is found liable, or who has admitted liability, for a particular breach of a trust under this Part is entitled to recover contribution from any other person also liable for the breach in such amount as will result in equal contribution by all parties liable for the breach unless the court considers such apportionment would not be fair and, in that case, the court may direct such contribution or indemnity as the court considers appropriate in the circumstances.[56]

To establish personal liability for a breach of trust under s. 13, it is necessary to demonstrate that: "(1) there is conduct by the corporation that amounts to a breach of trust; (2) the person is a director or officer of the corporation, or in effective control of it; and (3) the person knows or ought reasonably to know that the conduct amounts to a breach of trust and assents to or acquiesces in that conduct."[57]

Concerning (3), plaintiffs carry the burden to show: (a) the conduct by the corporation that constituted an appropriation or conversion of monies held in trust; (b) that the actions of the person being held personally liable constituted assent to, or acquiescence in, the corporation's conduct; and (c) knowledge or deemed knowledge on the part of the

[54] *Zurich Indemnity Co. of Canada v. Matthews* (2005), 44 C.L.R. (3d) 18 (Ont. C.A.) at para 26.
[55] See *Home Depot Inc. v. Fieder Painting Inc.*, 1995 CarswellOnt 4514 (ont. Gen. Div.).
[56] R.S.O. 1990, c. C.30, s. 13 (1) - (4).
[57] *Belmont Concrete Finishing Co. v. Marshall*, 2012 ONCA 585, C.L.R. (4th) 1 (Ont. C.A.) at para 4.

person being held personally liable that such conduct by the corporation constituted a breach of trust by the corporation.[58]

Under the *CLA*, no one is immune from personal liability by merely complying with section 35 of the *Trustee Act*. The Ontario Court of Appeal has made clear that:

> "The whole purpose of the Act is to protect persons supplying services and materials to an 'improvement' to real property…. The trustee must not appropriate funds to its own use or to a use inconsistent with the trust until all amounts owed money by the trustee for services or materials supplied to the improvement are paid. If we assume that a trustee passes the test of honesty required by s. 35, I do not see how the trustee could pass the test of reasonableness if it has acted contrary to the specific provisions of [the Act]. To say that the trustee's actions could be reasonable in such a situation would be to subvert the whole raison d'être of the Act."[59]

## C. Connecting a Trust Action and a Lien Action: Where the Ontario Construction Lien Act is headed if it is amended allow such things

Ontario is the only common law province to currently bar the joinder of lien and trust claims.[60] Section 50(2) of the *Act* prohibits the joining of trust and lien claims.[61] Reasons were explained in the 1982 Report of the Attorney General's Advisory Committee on the Draft *Construction Lien Act*. At that time, the committee perceived the issues underlying trust and lien claims to be different enough to leave procedural rules concerning trust actions out of the *Act*.[62]

To bypass the rule, "parties often request and obtain a 'connecting order' from a master or judge to procedurally connect lien and trust actions, so that their progress toward trial is coordinated and efficient."[63] The summary process that includes barring joinder of trust and lien actions has been criticized as unnecessary, lengthy and unduly costly.[64]

On the issue of joinder, the *Review* advocated for the removal of the bar against joinder of lien and trust claims. It specifically recommended that:

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[58] *Belmont Concrete Finishing Co. v. Marshall,* 2011 ONSC 1560, 7 C.L.R. (4th) 147 (Ont. Div. Ct.) at para 24.
[59] *Structural Contracting Ltd. v. Westcola Holdings Inc.* (2000), 2 C.L.R. (3d) 165 (Ont. C.A.) at para 30; leave to appeal refused *Structural Contracting Ltd. v. Westcola Holdings Inc.,* 2001 CarswellOnt 709, 2001 CarswellOnt 710 (S.C.C.) (citing *Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd.* (1999), 45 C.L.R. (2d) 178 (Ont. C.A.) at para 25.
[60] *Review*, page 101.
[61] "A trust claim shall not be joined with a lien claim but may be brought in any court of competent jurisdiction." R.S.O. 1990, c. C.30, s. 50 (2).
[62] *Review*, page 101.
[63] Duncan Glaholt, Conduct of a Trust Action (Toronto: Carswell, 2011) at 117.
[64] *Review*, page 92.

> "The prohibition on joinder of lien claims and trust claims under section 50(2) should be removed from the Act, subject to a motion by any party that opposes joinder on the grounds of undue prejudice to other parties."[65]

## III. DEFENCES TO BREACH OF TRUST ACTIONS

### A. Defences

Trust funds may be properly managed three ways: discharge (s. 10 *CLA*), reduction by substitution (s. 11 *CLA*), and by retainage for set off.[66]

A trustee must account for trust funds received.[67] In practice, this means demonstrating that project funds were paid to project beneficiaries. Towards this end, a trustee defending against a breach of trust claim may rely on evidence that it complied with sections 10 through 12 *CLA*.[68]

The court in *St. Mary's Cement Corp. v. Construc Ltd.*[69] offered additional guidance in demonstrating compliance with the *Act* and any outstanding duties and obligations that arise in relation to protection of the trust. It wrote:

> "The Act not only creates a specific project-related trust fund, but also specifically directs the trustee to hold those monies and to pay them only to the beneficiaries until there are no unpaid claims from those beneficiaries. In my opinion, the Act contemplates a separate trust fund for every project in which the contractor is involved and separate accounting for every trust fund. It is only by separately accounting for the monies held in trust that a contractor can ensure that trust monies are not in fact applied to other purposes. The fact that the Act

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[65] *Review*, page 102.
[66] *Review*, page 125-126.
[67] *Opec Acoustics & Drywall Ltd. v. Kascon Corp*. (1997), 34 C.L.R. (2d) 75 (Ont. Gen. Div.) at para 12: "A mere failure to account for funds to all subcontractors and other persons who supplies services or materials to the improvement for funds received prior to any appropriation or conversion of any part of the funds to the contractor's or subcontractor's own use or to any use inconsistent with that trust, is in itself a "breach of trust". The allegation of such failure to account is sufficient to validate pleadings in relation to a "breach of trust" created by the *Construction Lien Act* without anything else." In addition, recent caselaw has referenced authority for the proposition that a right of set off under s. 12 of the *Act* can only exist if the trustee has "retained" the trust funds (and did not spend the trust funds) i.e. the "subject matter" of the trust has been retained: *Yuanda Canada Enterprises Ltd. v. Pier 27 Toronto Inc.*, 2017 CarswellOnt 3791, 2017 ONSC 1892 (Ont. S.C.J.) (Master Wiebe) at para 24. Although not expressly cited by Master Wiebe on this point, existing decisions by the Ontario Court of Appeal support this conclusion: *Architectural Millwork & Door Installations Inc. v. Provincial Store Fixtures Ltd*., 2016 ONCA 320, 2016 CarswellOnt 6796, 51 C.L.R. (4th) 42 (Ont. C.A.), at para 12-14: "Provided the criteria of s. 12 of the [Act] are met, a trustee of the trust fund may, without breaching the trust, retain to general use… The availability of the right of set off under s. 12…including the existence of the trust funds…If no trust funds are retained or all the monies are spent, the purpose of the trust provisions is defeated and any right of set off is extinguished: *Arborform*…".
[68] Duncan Glaholt & Markus Rotterdam, "The Defences to Breach of Trust Actions — We Spent All the Money" (2002) 10 C.L.R. (3d) 262; *supra* notes 23-26.
[69] *St. Mary's Cement Corp. v. Construc Ltd.* (1997), 33 C.L.R. (2d) 234 (Ont. Gen. Div.).

> does not expressly require that trust funds be kept separate from the general accounts of the contractor is not determinative of whether a failure to do so constitutes a breach trust. A trustee has an obligation to protect the trust funds. Allowing trust funds to be intermingled with other monies and used for general purposes is inconsistent with the trustee's duty to maintain proper control of the trust funds".[70]

## B. Other approaches

### 1. *American Approach in New York law*

The *Review* commented favourably on the New York Model.

In New York State, *New York Lien Law* Article 3-A functions similar to Part II of the Ontario *Construction Lien Act*. In particular, *New York Lien Law* § 70 (1) defines trusts as:

> "[F]unds … received by an owner for or in connection with an improvement of real property in this state, including a home improvement loan, or received by a contractor under or in connection with a contract for an improvement of real property, or home improvement, or a contract for a public improvement in this state, or received by a subcontractor under or in connection with a subcontract made with the contractor for such improvement of real property including a home improvement contract or public improvement or made with any subcontractor under any such contract, and any right of action for any such funds due or earned or to become due or earned, shall constitute assets of a trust."[71]

There are two essential differences between Ontario and New York lien laws. The first is the manner by which a trustee, in New York, may rely upon specific conduct listed under the statute to defend against a claim for breach of trust. Compliance creates a *prima facie* defence. Under the *New York Lien Law*:

> 1. If the trustee deposits trust funds in a bank or other depositary they shall be deposited in his name.
>
> The trustee shall not be required to keep in separate bank accounts or deposits the funds of the separate trusts of which he may be trustee under this article, provided his books of account shall clearly show the allocation to each trust of the funds deposited in his general or special bank account or accounts.
>
> 2. Every trustee shall keep books or records with respect to each trust of which he is trustee and, if funds of separate trusts are deposited in the same bank account, shall keep a record of such account showing the allocation to each trust of the deposits therein and withdrawals therefrom…

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[70] *Ibid.* at para 36.
[71] NY Lien Law § 70 (1): Definition of Trusts, online: http://codes.findlaw.com/ny/lien-law/lie-sect-70.html.

> 4. Failure of the trustee to keep the books or records required by this section shall be presumptive evidence that the trustee has applied or consented to the application of trust funds actually received by him as money or an instrument for the payment of money for purposes other than a purpose of the trust as specified in section seventy-one of this chapter.[72]

Second, trustees under the *New York Lien Law* are subject to the same duties and obligations as any other trustees. Obligations and duties include:

> "A duty of loyalty to the beneficiaries, a duty to keep and render accounts for the beneficiaries, and keep trust funds separate from his own; a duty to furnish beneficiaries information and to permit them to examine the trust accounts; a duty to take proof of the trust assets and to enforce claims on behalf of the trust."[73]

The *Review* has recommended that all public projects require mandatory construction bonding for labour and material payment claims by construction sureties.[74] Most public projects in Ontario already have such bonds in place.

## IV. CONCLUDING REMARKS

The current *Act* is overdue for an overhaul. Construction trusts are a brilliant idea.[75] Yet, their current functioning is hampered by the lack of uniformity in practice in carrying such construction trusts into effect. The current overlay of the statutory trust scheme, on top of existing commercial relationships and the business practices of the construction industry in Ontario, has led to less than ideal outcomes for the industry.

Statutory construction trusts are powerful and effective remedies for unpaid contractors, subcontractors and suppliers. Although robust in their architecture, the current construction trust provisions of the *Act*, could be and should be improved by the recommendations of the *Review*, particularly as to project trust accounts.[76] A shortfall in a

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[72] *New York Lien Law* § 75: Deposit of funds of trust; books or records to be kept, online: http://codes.findlaw.com/ny/lien-law/lie-sect-75.html.

[73] *Frontier Excavating, Inc. v Sovereign Constr. Co.*, 30 A.D. 2d 487 (N.Y., A.D., 4th Dept., 1968) at p. 490.

[74] *Review*, page 151.

[75] Duncan Glaholt, "Managing Trust Funds, the New York Model" (2003), 21 C.L.R. (3d) at 75, cited in the *Review*, page 146.

[76] On March 21, 2017 the Ministry of the Attorney General announced the largest portion of the recommendations in the Expert Review will likely be tabled as legislation prior to the summer 2017 recess. The Ontario Ministry of the Attorney General has signalled that what is likely to be *excluded* from the proposed bill will be the pilot project for public sector trust accounts, certain technical CLA amendments relating to property identified numbers, and liens expiring on a lot by lot basis. On May 31, 2017, Bill 142, the *Construction Lien Amendment Act*, 2017, received first reading. Among other provisions, new s. 8.1(1) is contemplated to require a trustee to maintain written records respecting the trust funds, detailing the amounts paid in and paid out. Such funds may be deposited into a single account provided that required trust records are separately maintained in respect of each trust. Further, new s. 8.1(2) provides; "Trust funds from separate trusts that are deposited together into a single bank account…are deemed traceable…and the depositing does not constitute a breach of trust". See Appendix A excerpt from Bill142.

mixed trust account can be addressed more efficiently, and without the trust asset becoming property of the bankrupt/insolvent as it remains "property held in trust for any other person" within the meaning of section 67(1) *BIA*. Further, the administrative burden of multiple separate trust accounts is absent if such recommendations were followed in practice, or enacted by the Ontario legislature.

One compromise may be to exempt public projects from the first tier of trust accounts, and the concomitant administrative cost and burden, where the public owner (as opposed to a Project Co. in the PPP model) remains a public owner when the likelihood of public owner default is virtually nil.

Recent recommendations made by the *Review* do much to facilitate bringing construction trusts into the modern era for the benefit of those who improve our built environment. It would be a shame not to consider them.