

FOCUS

ON

Construction Law

Bankruptcy doesn't shelter the dishonest



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The recent recession has spawned an unprecedented spike in personal bankruptcy filings. According to figures from the Office of the Superintendent of Bankruptcy Canada, personal bankruptcies hit a record high of 116,381 in 2009, falling slightly in 2010.

A question for those in the construction industry is this: Does liability for breach of trust under s. 13(1) of Ontario's *Construction Lien Act* (CLA) survive a discharge from bankruptcy?

The CLA impresses money received on construction projects with a trust. Generally speaking, a contractor or subcontractor who receives money on account of a contract on a construction project must use the money first to pay those who provided services or materials on the project. Failure to pay subtrades will generally constitute a breach of trust.

Pursuant to s. 13(1), a director, officer or any other controlling minds of a corporate contractor 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 personally liable for the breach. In effect, this section allows a trust beneficiary to pierce the corporate veil and legally pursue individuals with control of a company who participated in the breach of trust.

Bankruptcy law makes possible the rehabilitation of bankrupt individuals by discharging them from the burden of past debts, subject to certain exceptions. Section 178(1)(d) of the *Bankruptcy and Insolvency Act* (BIA) provides that an order of discharge does not release the bankrupt from "any debt or liability arising out of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity."

In *Simone v. Daley*, [1999] O.J. No. 571, the Ontario Court

of Appeal made clear that not every breach of fiduciary duty will survive bankruptcy. There must be "some element of wrongdoing or improper conduct" in the sense of a failure to account properly for money or property entrusted to the fiduciary or inappropriate dealing with such trust property. Since one of the primary purposes of the BIA is to give honest but unfortunate debtors a fresh start, it makes sense to forgive them of liability resulting from simple inadvertence, negligence or incompetence. *Simone* has been embraced by courts in Ontario, British Columbia, Manitoba and Alberta. (See, for example, *Valastiak v. Valastiak*, [2010] B.C.J. No. 233; *Brunt v. Garlicki*, [2010] M.J. No. 230; *Kennedy v. Bohnet*, [2002] A.J. No. 368.)

In *Toro Aluminum Ltd. v. Revah*, [1999] O.J. No. 5346, Justice Anne Malloy applied the reasoning in *Simone* to CLA trust claims. For a s. 13(1) breach of trust claim to survive bankruptcy under s. 178(1)(d) of the BIA, there must be a sufficient extent of dishonesty, wrongdoing or misconduct by the bankrupt in his or her fiduciary capacity.

There are two extremes, as Justice Malloy explained. The first is where there is a failure to pay trust money to third parties due to inadvertence; the other is where a trustee deliberately misappropriates trust money for one's own use so as to defeat the beneficiary's claim. In the former situation, s. 178(1)(d) would not apply; in the latter, it would. The difficult cases are those that fall between these two extremes.

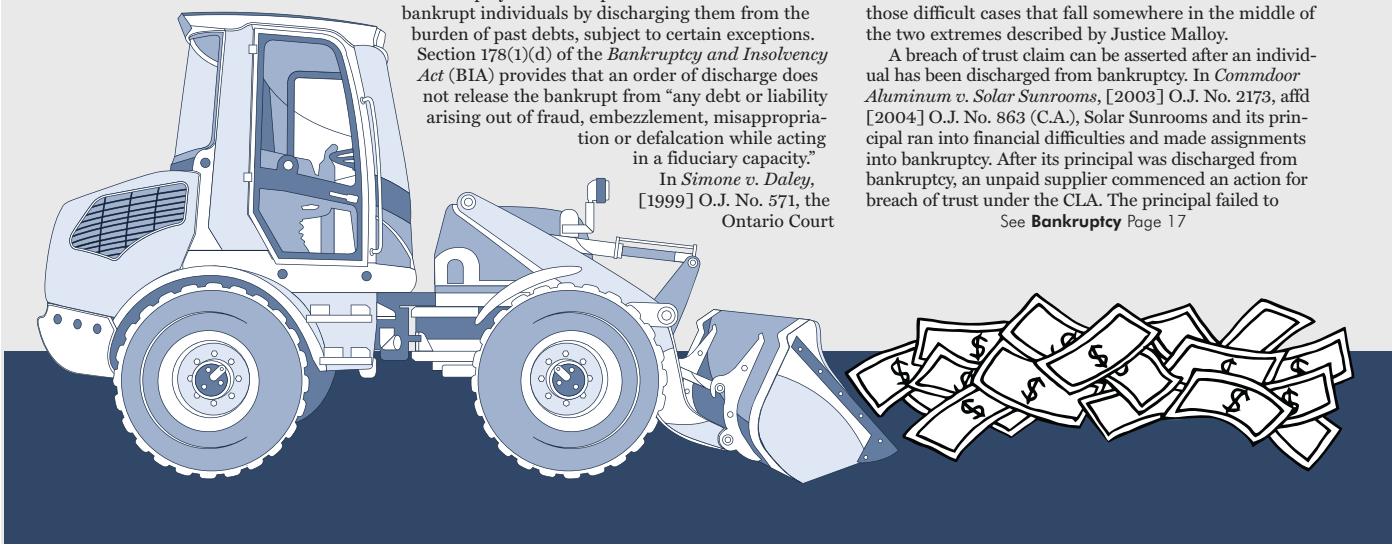
For s. 178(1)(d) to be engaged, two elements must be proved: (1) the bankrupt was guilty of "fraud, embezzlement, misappropriation or defalcation" (the wrongful use of someone else's money); and (2) the wrongful use of money was made by the bankrupt while acting in a fiduciary capacity.

Toro Aluminum and subsequent cases all involved facts that lend readily to a finding of misappropriation or defalcation. In *Dicroce (Re)*, [2004] O.J. No. 1742, for example, the bankrupt admitted to dipping into trust funds for his personal use. Similarly, in *Re Zumbo*, [2000] O.J. No. 1759, an experienced contractor who failed to keep proper books and records with respect to construction trust moneys was found liable to an unpaid subcontractor and his liability survived bankruptcy.

It remains to be seen how a court will rule in one of those difficult cases that fall somewhere in the middle of the two extremes described by Justice Malloy.

A breach of trust claim can be asserted after an individual has been discharged from bankruptcy. In *Commodo Aluminum v. Solar Sunrooms*, [2005] O.J. No. 2173, aff'd [2004] O.J. No. 863 (C.A.), Solar Sunrooms and its principal ran into financial difficulties and made assignments into bankruptcy. After its principal was discharged from bankruptcy, an unpaid supplier commenced an action for breach of trust under the CLA. The principal failed to

See **Bankruptcy** Page 17



FOCUS

Construction Law

In construction, something to lean on

Mention "construction lien" and most lawyers cringe. They complain that it is too complicated. The long-awaited third edition of *A Guide to Construction Liens in Ontario* is a "must have" reference book for them and for everyone whose work includes construction liens in Ontario. For this edition, Harvey Kirsh collaborates with Matthew Alter, with whom he has teamed on a number of publications. Both are well-respected lawyers with a long history of publishing definitive works in their specialty fields. Together, Kirsh and Alter, with a combined experience of more than 60 years at the Bar, are an information powerhouse. They generously share their expertise and experience with you, the reader, without holdback.

The book provides a thorough examination of the topic, combining practical information with easy-to-follow examples, useful precedents and academic analysis. Whether you are arguing a construction lien case in court, negotiating with the other players in a construction project where liens have been registered or threatened, or managing a large construction project, this text will be a helpful resource to add to your library.

The third edition arrives 16 years after the second edition. It provides important legislative updates, judicial interpretation through extensive case law, the authors' commentary and up-to-date precedents. The historical perspective at the beginning of the work provides valuable insight into how the industry achieved the present form of construction lien legislation. It also describes recent legislative amendments and the resulting changes to construction practice, effective in 2010 and 2011, including electronic registration and eliminating the affidavit of verification. Aside from interesting reading, the legislative background can be



**MASTER
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ALBERT**

BOOK REVIEW



TITLE:
*Kirsh and Alter:
A Guide to Construction
Liens in Ontario, 3rd edition*
AUTHOR:
Harvey J. Kirsh
and Matthew R. Alter
PUBLISHER:
LexisNexis Canada Inc.

helpful as an aid to interpretation in the face of ambiguity.

The book is written in an academic, digest style with concepts explained in paragraph form and frequent footnotes citing cases, examples and other relevant authorities. A detailed table of contents, index and table of cases will help the reader find what he or she is looking for.

Kirsh and Alter tackle some of the more confusing construction lien concepts with the use of helpful examples, such as at pp. 110 and 113 where the authors use diagrams to illustrate important timelines. Another helpful example is found at p. 118 where the authors discuss the complexities of sheltering lien claims.

Readers who take the time to work through these examples will be rewarded with clarity.

At p. 153 Kirsh and Alter explain clearly the difference between "discharging" and "vacating" a lien, a concept that mysteriously continues to baffle many practitioners. A lawyer who incorrectly registers a discharge of lien, when the court has ordered it vacated, improperly extinguishes a lien claimant's rights. In the book reviewer's opinion, this amounts to professional negligence. Lawyers should read this section of the Kirsh and Alter book carefully.

I urge all lawyers who work in this practice area to read and absorb Ch. 12 (e-registration). It explains proper procedure and steps to take in a paperless registry system, including how to protect yourself from your client, both critical to a successful practice.

In Ch. 9 the authors provide a step-by-step guide if you are taking a lien claim to court or defending such a claim, including identifying the proper court to go to, who must be named as parties to the action, what to do about a bankrupt defendant, when and how to issue a counter-claim or cross-claim, circumstances in which third party proceedings are permitted, court procedure, motions (including when a motion may be brought "as of right" and when leave is required) and the conduct of a lien trial. This chapter is very useful for lawyers and non-lawyers alike. For the latter group it provides insight into what happens if the conflict cannot be resolved short of trial.

In addition to the text, the authors provide precedents of forms, pleadings and other materials that are required to practice in this area. Whether you are newly involved in construction lien practice or a seasoned advocate, or even if you have only the occasional construction lien file, these preced-

ents will be helpful.

The only caution I have for this book is if the intended audience includes self-represented litigants, then much of the text will be too technical and too detailed to meet their needs. On the other hand, self-represented litigants should find the precedents useful, if for no other purpose than to illustrate the need for competent counsel experienced in this complex practice area.

In conclusion, if the goal of Kirsh and Alter in publishing a third edition of *A Guide to Construction Liens in Ontario* is to provide an authoritative and definitive, up-to-date guide on

construction law in Ontario, the authors have succeeded. I recommend the book to lawyers (generalists and specialists alike) who encounter construction lien issues as any component of their practice as well as to those who work in the construction industry. ■

Master Carol Albert: JD 1980 (Osgoode); LL.M. in ADR 1998 (Osgoode); 16 years with Gardiner, Roberts; appointed case management Master of the Superior Court of Justice in 1998; construction lien Master since 2001.

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Kirsh and Alter: A Guide to Construction Liens in Ontario, 3rd Edition

Harvey J. Kirsh, B.A., LL.B., LL.M., C.S. &
Matthew R. Alter, B.A., LL.B., C.S.

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Directors can be on hook

Bankruptcy

Continued From Page 16

account for what happened to moneys received to show that moneys were expended properly, which amounted to a breach of trust that attracted s. 178(1)(d) of the BIA. The court further held that the discharge from bankruptcy did not release the trustee from his fiduciary obligations.

The conclusion to be drawn from these decisions is that dishonest contractors and those

who breach their fiduciary obligations under the CLA cannot escape personal liability by assigning themselves into bankruptcy. Unpaid suppliers and subcontractors may continue to pursue their CLA trust claims in the face of bankruptcy of a corporation's directing minds. Provided that they can establish wrongdoing on the part of the directors of the type described in *Simone*, they may be able to trace the trust funds into property purchased by the directors

and recover something at the end of the day. ■

Samuel Marr is the President of the Toronto Lawyers Association, a senior partner at Landy Marr Kats LLP and is certified as a specialist in civil litigation by the Law Society of Upper Canada. Anna Wong practises civil litigation at Landy Marr Kats LLP in Toronto. Prior to joining Landy Marr Kats LLP she clerked at the Ontario Superior Court of Justice.