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Reining in Construction Trust Claims

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Belmont Concrete Finishing Co. v Marshall (2011), 338 D.L.R.(4th) 144, 2011 ONSC 1560 (Ont. C.A.) (click on case name for full text of case)

Internorth Construction Company ("Internorth") was a general contractor. Its only directors between 2001 and 2004 were Marshall and Hooks. It ran into financial difficult and ultimately ceased operations in 2004. A number of Plaintiffs sued Internorth, Marshall, Hooks and various former officers and directors for breach of trust. Judgment was obtained against Internorth for breach of trust on an unopposed basis and the claims against all of the other Defendants, but for Marshall, were disposed of prior to trial. Only the claim against Marshall went to trial.

In the trial decision, the Trial Judge set out three requirements necessary to impose liability for breach of trust under Section 13 of the Construction Lien Act ("the Act") all of which were accepted by the Court of Appeal: (1) a breach of trust by the corporation; (2) the individual must be a director or officer or a person with effective control of the corporation; and, (3) the individual must have assented to, or acquiesced in, conduct the person knew or reasonably ought to have known amounted to a breach of trust by the corporation. The Trial Judge noted that the Plaintiff has the burden of proof of each of these elements.

The Trial Judge accepted that the first element was established by the summary judgments obtained earlier against Internorth. The second element was proven and was not seriously in dispute. With respect to the third element, the Trial Judge rejected that Marshall had been involved in the monitoring of receipts and disbursements from January 1, 1999 but found he knew or should have known that payments were being made by Internorth in breach of trust from the end of May of 2002. Marshall argued that in the absence of evidence as to the timing of the specific projects and the specific receipts and disbursements on these projects, the Trial Judge could not find Marshall liable under Section 13. However the Trial Judge rejected this on the basis that there was evidence that Marshall had personally received payments to his own benefit knowing that the Plaintiffs' claims remained unsatisfied and that Internorth had previously wrongly paid out trust funds.

On appeal, the Court of Appeal overturned the judgment and dismissed the claims against Marshall. It prefaced its decision on the merits of the case with several observations about the liability imposed under Section 13. Firstly it noted that the Act was not intended to impose liability on individuals for every breach of trust by the corporation. Secondly, the Court of Appeal noted that the breach of trust by an individual under Section 13 is the action of the appropriation or conversion, not the failure to remedy a breach of trust after an appropriation or conversion has occurred. Thirdly the Court of Appeal noted that the mere failure to pay a subcontractor is not a breach of trust and the Plaintiff must establish the alleged breach of trust based on the analysis of the actual receipts and disbursements on a project by project basis.

In considering the correctness of the trial judgment, the Court of Appeal noted that the reliance by the Trial Judge on an unopposed judgment obtained by the Plaintiffs against another Defendant was problematic but because Marshall did not contest this, the Court limited its analysis to the third required element. In that regard, the Court did not accept the trial judgment for the following reasons:

1. The Trial Judge (and evidence) failed to identify the particular payments and conduct which constituted the breach of trust.

2. The Trial Judge wrongly appeared to consider that the receipt of the funds from Internorth by Marshall, after prior unspecified breaches of trust by the Internorth, established liability under Section 13. The Appeal Court reiterated that it was not a breach of trust to fail to remedy a prior breach of trust, though Internorth's liability for a breach of trust would not be discharged until the trust beneficiaries were paid. A breach of trust is a distinct occurrence and in this case was not identified and proven against Marshall.
3. The Court of Appeal disputed that the payments received by Marshall were in and of themselves breaches of trust in the absence of evidence that they were actually paid out of trust funds in respect of which the Plaintiffs were beneficiaries. There was no such evidence.

The Court was not prepared to conclude that the insolvency of Internorth necessarily established a breach of trust because Marshall had possibly received payments from Internorth when it was insolvent.

The decision represents a strong message to the construction litigation industry that in order to establish personal liability, the Court will require specific evidence as to the receipt and disbursement of funds on the specific project which has given rise to the Plaintiff's claim. Trust cases can be difficult, particularly where the corporation is insolvent because the books and records may not be available or may be in a poor state. There is a tendency to believe that rolling a big ball of smelly mud into court will necessary result in a successful outcome. The Court of Appeal appears to be reminding counsel that the court will not connect the dots without sufficient evidence, even where the facts available give off a strong odour.