

**ARE CLAIMS UNDER *THE CONSTRUCTION LIEN ACT* DISCHARGED BY  
BANKRUPTCY?**

By Samuel S. Marr<sup>1</sup>

**INTRODUCTION**

The *Construction Lien Act* creates a trust regime for construction projects. To protect construction trades, the legislature has created a statutory trust which mandates that monies received on construction projects are trust monies, which can only be released in accordance with the provisions of the *Act*, and the case law interpreting the *Act*.

Section 13 of the *Act*, provides for liability for any person, whether an officer, director or otherwise having effective control, who causes a corporation to breach the trust provisions of the *Act*. The Courts will often pierce the "corporate veil" holding individuals personally liable for failing to pay their subtrades.

This paper will address what happens when such individuals make an assignment into bankruptcy. Will existing breach of trust claims survive bankruptcy, or will they be extinguished upon the discharge of the bankrupt?

Section 178(1) of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.B.3, as amended, provides:

**178 (1) An order of discharge does not release the bankrupt from...**

**(d) any debt or liability arising out of fraud, embezzlement,  
misappropriation or defalcation while acting in a fiduciary  
capacity...**

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**SIMONE et al v DALEY**

In *Simone et al v Daley* (1999) 43 O.R. (3d) 511 the Ontario Court of Appeal looked at the issue of when a claim for breach of fiduciary duty will be discharged from bankruptcy. *Simone* was **not** a case involving the trust provisions of the *Construction Lien Act*.

The Court looked at the purpose of the bankruptcy legislation:

In my view, the former approach is the correct one, having regard to the purposes of bankruptcy legislation and to the language used in section 178, and keeping in mind as well that not all breaches of obligation by a fiduciary are breaches of a fiduciary obligation. They may simply be inadvertence, negligence or incompetence.

...[I]f bankrupts are normally saved from the consequences of their negligence or incompetence by a discharge, it makes no sense that they should remain accountable for similar conduct simply because the conduct is carried out by someone who may now be classified as falling within a certain category of relationship, namely that of fiduciary. The courts have resisted a rigid approach to the determination of what constitutes a fiduciary relationship, as previously noted, emphasizing that it is "the nature of the relationship and not the category of Actors involved" which is important for purposes of that exercise. In this same spirit, it seems to me, the courts should avoid attempting to sweep into concepts such as "misappropriation" or "defalcation" -- which in their ordinary meanings connote some element of wrongdoing, improper conduct, or improper accounting -- any and all failures by the fiduciary to comply with the obligations attending upon that capacity. When it comes to the application of insolvency legislation, the results of not resisting that temptation can be far reaching and inconsistent with the purposes of such legislation.

*Simone* made it clear that not every breach of fiduciary duty will survive bankruptcy. The question to be faced after *Simone* is whether claims for breaches of trust under the *Lien Act* had a sufficient element of "wrongdoing" to survive bankruptcy.

**TRIAL DECISIONS AFTER *SIMONE v DALEY***

After *Simone* several trial courts looked at the issue of whether breach of trust claims under the *Construction Lien Act*, would be discharged by bankruptcy.

For example, in *Toro Aluminium Ltd. v Revah*, Madam Justice Molloy wrote:

Based on the reasons of the Court of Appeal in *Simone v Daley*, it cannot be said that any findings of liability under the trust provisions of the *Construction Lien Act* will constitute a liability falling within section 178 (1)(d) of the *Bankruptcy and Insolvency Act*. One can imagine situation in which there could be breach of the trust provisions in the CLA without any deliberate wrongdoing on the part of the trustee. For example, funds might be paid out to third parties due to inadvertence or an accounting error. Such conduct might not fall within the Court of Appeal test as articulated in *Simone and Daley*. However, there will certainly be some breaches of trust under the *Construction Lien Act* which will fall clearly within section 178 (1)(d) of the *Bankruptcy and Insolvency Act*. An obvious example is where a trustee deliberately misappropriates trust money for his own use so as to defeat the claim of beneficiary. In between these two extremes, there is a spectrum of conduct which breaches the CLA, but which may or may not fall within section 178 (1)(d) of the *Bankruptcy and Insolvency Act*, depending on the extent to which there was any wrongdoing or improper conduct by his bankrupt in his fiduciary capacity.

*Toro Aluminium Ltd. v Revah* [1999] O.J. No. 5346, para 13

Madam Justice Malloy further wrote:

“In order to succeed under section 178 (1)(d) of the *Bankruptcy Act*, Toro must establish two things:

1. that Mr. Revah was guilty of "fraud, embezzlement, misappropriation, defalcation", and
2. that this conduct by Mr. Revah was while he was "acting in a fiduciary capacity".

I have already found that Mr. Revah's conduct amounted to a breach of trust.

In my view, this test is easily met on the facts of this case. Mr. Revah, as the sole officer, director and directing mind of Al-Rev, had a duty to preserve the trust funds for the benefit of those entitled to them. This constitutes a fiduciary responsibility. The Court of Appeal held in *Simone and Daley* at page 529 that there must be "some element of wrongdoing or improper conduct on the part of the fiduciary question in the sense of a failure to account properly for monies or properly entrusted to the fiduciary in that capacity or inappropriate dealing with such trust property". Mr. Revah was entrusted with money impressed with a trust. He has failed to provide any proper accounting as to his dealings with the trust money. Further the evidence disclosed that substantial amounts of the trust fund were deposited directly into Mr. Revah's personal bank account or were transferred from Al-Rev's account into Mr. Revah's personal account. This is a clear misappropriation of trust funds for personal benefit and falls squarely within the principles enunciated in *Simone and Daley* as the kind of liability that should not be extinguished by bankruptcy. Accordingly, a declaration shall issue that the indebtedness of Armond Revah to the applicant, Toro Aluminium Limited, pursuant to the report of Master Linton dated March 3<sup>rd</sup>, 1997 survives the bankruptcy of Armond Revah."

*Toro Aluminium Ltd. v Revah* [1999] O.J. No. 5346, para. 42 & 43

Similarly in *Zumbo Re*, Madam Justice Greer, wrote:

In the case at bar, I am satisfied that *Zumbo* did not act through simple inadvertence, negligence or incompetence. *Zumbo* was an experienced contractor of many years' standing. He was well aware of the provisions of the CLA. He chose to completely ignore those provisions, keeping no books of record and thereby preventing anyone from tracing the money he received for the jobs where Commdoor supplies were used, to determine how he had applied it. *Zumbo* was aware of his obligation as a trustee of the monies given to him for work done on projects and was aware that he was not applying the money to persons or companies who had supplied services or goods for that project. He never distinguished the two companies he had, one from another, nor did he distinguish his role as a trustee from himself as the directing mind of all projects. S.13 (1) of the CLA speaks of any person, "... who assents to, or acquiesces in, conduct that he or she knows or reasonably ought to know amounts to breach of trust...", is liable for that breach. Marchand J. found such breach, and that Order was never appealed from by *Zumbo*. *Zumbo* caused his two companies to pay some of the contractors on the various projects but failed to pay Commdoor. He also

failed to obey the Order of Master Cork that he provide such an accounting. *Zumbo* chose not to testify in the bankruptcy proceedings before me on this Motion. He will, however, have to testify when the opposition to his discharge by the CIBC is heard.

*Zumbo (RE)* [2000], O.J. No. 1759, para. 9

**COMMDOOR v SOLAR SUNROOMS INC., (Ont.C.A.)**

After *Zumbo* and *Toro Aluminum* were decided, the Ontario Court of Appeal in *Commdoor Aluminum v. Solar Sunrooms Inc. et al.* (2004) (Ontario Court of Appeal) (found at the back of this paper) was provided with an opportunity to examine the issue of when the liability of a trustee under the *Lien Act* would be discharged by bankruptcy.

Counsel for the Appellant argued that the breach of trust in *Commdoor* was the result of incompetence in the keeping of accounting records, and that therefore the claim was discharged by bankruptcy because it was not the type of “wrongdoing” described in *Simone*. This argument ignored an important passage in *Simone*, in which the Court of Appeal wrote:

Consequently, I am not persuaded that the exception to a release of liability upon a bankruptcy discharge which is provided for in paragraph 178(1)(d) of the BIA should be extended to conduct which does not display at least some element of wrongdoing or improper conduct on the part of the fiduciary in question in the sense of a **failure to account** properly for monies or property entrusted to the fiduciary in that capacity or inappropriate dealing with such trust property (emphasis added)

But it is precisely the failure to account and to keep adequate books and records which is most commonly found in breach of trust cases, including the case argued by the Appellant in *Commdoor*.

Accordingly, the Court of Appeal in *Commdoor* dismissed the appeal:

The trial judge found as a fact that the appellant had failed to adequately discharge his onus as a trustee to account for the relevant trust funds. That finding, which is supported by the evidence, is sufficient to trigger s. 178(1)(d). (See *Simone v. Daley* (1999) 43 O.R. (3rd) 511 at 529).

The Court of Appeal has made it clear that if a person receives trust monies under the *Construction Lien Act*, he must account for what happened to the money. If the trustee cannot (as in *Commdoor*) provide a satisfactory explanation or records demonstrating that the monies were expended properly, this constitutes a breach of trust, and such a breach of trust claim will survive bankruptcy.

### **THE JURISDICTIONAL ISSUE**

One final point, which needs to be addressed, is the jurisdictional issue.

There is some division among Judges about whether the issue of discharge of breach of trust claims should be adjudicated in a bankruptcy proceeding, or as an issue in the action for breach of trust under the *Lien Act*.

In *Tri-Con Concrete Finishing Co. v. Caravaggio* (2002) Kirsh's C.L.C.F. 13.58 (Ont. S.C.J.), a decision of Wilkins, J., dated July 9, 2002, the Court indicated that the issue of whether a claim

for breach of trust survived bankruptcy should be dealt with in the bankruptcy proceedings, and not in the context of the breach of trust action.

This view has been ignored by other Courts as it was, for example, in *Toro Aluminium*. By its decision in *Commdoor*, the Court of Appeal has arguably laid this issue to rest. Although this issue was not directly raised on the Appeal, the trial judge in *Commdoor* declared that the breach of trust claim survived bankruptcy, and did not require the issue to be dealt with in a bankruptcy proceeding. The Court of Appeal upheld the trial decision, without commenting upon any jurisdictional question, and one could conclude that this was confirmation of the process followed by the trial judge.

I would argue that upon bankruptcy, counsel for the Plaintiff in the breach of trust action should obtain a Court order both ending the automatic stay of proceedings under the *Bankruptcy Act*, and ordering the continuation of the breach of trust action against the bankrupt. The issue should then proceed to trial in the breach of trust action, and not be dealt with in a bankruptcy proceeding.

Samuel S. Marr

Toronto, June 2004

**DATE: 2004-03-09**  
**DOCKET: C40192**

**COURT OF APPEAL FOR ONTARIO**

**RE:           COMMDOOR ALUMINIUM (Plaintiff/Respondent) v. SOLAR  
SUNROOMS INC., SOLAR SUNROOMS LTD. AND GIUSEPPE  
DEMARCO, also known as JOE DEMARCO AND MARISA DEMARCO,  
also known as MARISA ROMANO (Defendants/Appellants)**

**BEFORE:    McMURTRY C.J.O., MOLDAVER AND CRONK J.J.A.**

**COUNSEL:   Barry A. Percival, Q.C. for the appellants  
              Samuel S. Marr for the respondent**

**HEARD & ENDORSED:   March 9, 2004**

**On appeal from judgment of Justice E. Loukidelis dated May 28, 2003.**

***A P P E A L   B O O K   E N D O R S E M E N T***

[1] The appellant concedes that for the purposes of s. 178(1)(d) of the *Bankruptcy and Insolvency Act* that the appellant DeMarco was *acting* in a fiduciary capacity. He agrees that his failure to account for the trust money in issue was due to his incompetence and negligence and not any wrongdoing or misconduct within the meaning of s. 178(1)(d). We disagree.

[2] The trial judge found as a fact that the appellant had failed to adequately discharge his onus as a trustee to account for the relevant trust funds. That finding, which is supported by the evidence, is sufficient to trigger s. 178(1)(d). (See *Simone v. Daley* (1999) 43 O.R. (3rd) 511 at 529.

[3] Accordingly, the appeal is dismissed with costs fixed in the amount of \$6,115.69.