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No Security for Costs for Defendants With Trust Funds

Defendants may be denied security for costs if they have holdback in trust that exceeds their reasonable costs of the action. In *Yuanda Canada Enterprises Ltd. v. Pier 27 Toronto Inc.* ("**Pier 27**"),[1] McMillan LLP successfully argued that the longstanding common law rule that security for costs should be denied where the defendant admits to owing the plaintiff money should apply where an owner has holdback in trust for the plaintiff.

Master Wiebe's decision on this issue appears to be a novel application of the common law rule in the construction context. As such, owners and contractors in construction cases should now consider this rule when deciding whether to pursue security for costs motions if they have holdback funds in trust.

Yuanda Does the Work but Defendants Fail to Pay Despite Certification

Yuanda Canada Enterprises Ltd. ("**Yuanda**") is the Canadian subsidiary of one of the world's largest curtain wall installers. The defendant owners of the Pier 27 condominium project in Toronto hired Yuanda as the curtain wall contractor for the project.

The prime contract made the defendants' site superintendent or project manager responsible for payment certification. Seventeen progress payment applications were certified, and the total holdback

[1] 2017 ONSC 1892 ("*Pier 27 Decision*").

on the certified and paid payment certificates was $1,312,235.13 (including HST) (the "**Holdback Funds**").

Although Yuanda performed the work, the owners failed to pay all of its invoices when they came due. As a result, Yuanda registered a claim for lien and an action seeking payment in the amount of $3,118,616.18, which included the Holdback Funds. The defendants brought a security for costs motion for an order requiring Yuanda to post security in the amount of $527,067.64.

Defendants Denied Security for Costs Due to Holdback Held in Trust

The defendants brought their security for costs motion under rule 56.01(1)(d) of the *Rules of Civil Procedure*.[2] There is a two-part test under this rule. In the first part, the moving defendant bears the onus. It must show that there is good reason to believe the plaintiff has insufficient assets in Ontario to pay the defendant's costs. If the defendant succeeds, then the onus shifts to the plaintiff to prove that it (i) is impecunious and has a meritorious claim; or (ii) has sufficient assets in Ontario to pay a cost award.

In addition to its other successful arguments, McMillan argued that even if the defendants met their initial burden under part one of the test, the Court should deny the motion because Yuanda had sufficient assets to pay a costs award. The Holdback Funds were one of those assets.

McMillan argued that the Holdback Funds were trust funds held for Yuanda's benefit. *Construction Lien Act* ("**CLA**")[3] section 7(2) states that "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." The fact that the payments were certified and that the owners' representatives were

[2] R.R.O. 1990, Reg. 194.

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

"Payment Certifiers" within the meaning of the CLA were not disputed by the defendants. As such, Master Wiebe concluded that the Holdback Funds were trust funds held for Yuanda's benefit.[4] There was no dispute that Yuanda had the only claim to the basic holdback.

The defendants argued that the Holdback Funds were not an asset of Yuanda because they were subject to set-off claims from the defendants that exceeded the total amount of the Holdback Funds. They claimed that set off was expressly authorized by sections of the prime contract, which stated that any certified draw was subject to a final accounting.[5]

Master Wiebe rejected the defendants' set off argument. Section 5(1) of the CLA provides that any contract term is subject to the overriding provisions of the CLA. Section 12 of the CLA only permits a trustee to set off if it proves that it retained (and did not spend) the trust funds. There was no evidence in the motion that the defendants retained the trust funds. As such, the defendants failed to prove that they could set off against them. Accordingly, Master Wiebe concluded that the defendants held the Holdback Funds in the amount of $1,312,235.13 (including HST) in trust for Yuanda.[6]

Master Wiebe then applied the common law rule that security for costs should be denied where the defendant admits to owing the plaintiff money that exceeds the total amount of security sought. This principle was clearly articulated in *Clark v. Tiger Brand Knitting Co.*, where the court noted that "[b]ecause the defendant [was] admittedly indebted to the plaintiff in an amount greater than its anticipated costs in defending the action, it [could not] be in need of protection for its costs of defence."[7] Similarly, in *Cortes v. Lipton Bldg. Ltd.*, the master refused to order security for costs where the defendant admitted substantial monies were owing to the plaintiff in

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[4] *Pier 27 Decision* at para. 22.

[5] *Pier 27 Decision* at para. 23.

[6] *Pier 27 Decision* at para. 24.

[7] *Clark v. Tiger Brand Knitting Co*, 1986 CarswellOnt 385 at para. 12, 10 C.P.C. (2d) 288.

respect of a mortgage.[8] In *Engebretson Group Company v. Grossman et al*, the master also set aside an order for security for costs because the defendant owed the plaintiff money, and that sum of money could be applied to the defendant's costs.[9] Master Wiebe found that there was a close parallel between the Pier 27 case and those cases where security for costs was denied because the defendant admitted owing the plaintiff money. As such, he held in obiter dicta that security for costs should be denied on this basis.[10]

Implications of the Decision

Master Wiebe's decision on this issue appears to be a first application of the common law rule in the construction context. As such, it provides important guidance to owners and contractors who are considering pursuing a security for costs motion.

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[8] *Cortes v. Lipton Building Ltd*., 1963 CarswellOnt 279 at para. 2, [1963] 1 O.R. 187 (Master).

[9] *Engebretson Grupe Co. v. Grossman*, 1937 CarswellOnt 200, [1937] O.W.N. 393 (H.C.J.).

[10] *Pier 27 Decision* at paras. 26 and 27.