

CONTRACTORS MAY BE LIABLE IN BREACH OF TRUST ACTIONS FOR INTEREST AND COSTS

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Officers and directors of contractors may soon know whether they can be liable for breach of trust if they fail to hold an amount equal to interest and costs in trust. In a recent decision in *Deep Foundations Contractors Inc. v. Gottardo* ("**Deep Foundations**"),^[1] the Court suggested that officers and directors are more likely to be liable if the subcontract expressly provides for the payment of those amounts. Although this question is currently unresolved, it will likely be addressed if *Deep Foundations* proceeds to trial.

Facts

In *Deep Foundations*, the Greater Toronto Transit Authority ("**GTTA**") hired a contractor, B. Gottardo Construction Ltd. ("**Gottardo**"). Gottardo hired *Deep Foundations Contractors Inc.* ("**DF**") as a subcontractor to perform shoring and foundation work on the GTTA project. The subcontract provided that DF was to be fully paid (including the holdback) within 45 days of substantial completion of its work. It further provided that interest on overdue accounts was to be charged at a rate of 2 percent per month but was silent on the issue of costs.

DF completed its work on the project on September 17, 2009 but Gottardo failed to pay DF within 45 days. As a result, DF registered a Claim for Lien and sued Gottardo. Five years later, in May 2014, DF had received full payment for the cost of its materials and services for the GTTA project, leaving interest and costs as the only remaining issues for trial.

On August 28, 2015, a bankruptcy order was made against Gottardo. As a result, DF's action for interest and costs was automatically stayed.

On September 25, 2015, DF sued the officers of Gottardo for breach of trust under the *Construction Lien Act* ("**CLA**").^[2] DF alleged that Gottardo had received payment from GTTA for the project and that those funds were the subject of a trust under CLA section 8. DF further claimed that interest and costs were included in the trust amount. By the time that the action was commenced, the interest and costs totaled approximately \$700,000.

Unclear Whether Interest and Costs Recoverable in a Breach of Trust Claim

The question of whether interest or costs can be recovered through a breach of trust claim depends on the interpretation of the trust provisions in the CLA. Section 8(2) of the CLA describes the obligations of the trustee as follows:

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. [emphasis added]

The issue in *Deep Foundations* was whether "all amounts" in section 8(2) includes interest and costs. If it does, and the officers failed to hold those amounts in trust, they could be personally liable for breach of trust. If "all amounts" does not include interest and costs, the officers could not be liable because DF had already been paid "all amounts" (i.e. the price for the supply of materials and services).

The defendant officers argued that the words "all amounts related to the improvement" only include services and materials, not interest and costs. They claimed that this restrictive interpretation of section 8(2) is supported by the language of CLA section 8(1). Section 8(1) states that the funds that are subject to the trust include "all amounts...received by a contractor...on account of the contract or subcontract price..." [emphasis added]. The definition of "price" in the CLA does not include interest and costs.

The defendants argued that a requirement to hold interest and costs would also be unreasonable. If such an obligation were imposed, the defendants may have been required to add their own funds to the trust account to ensure there were sufficient funds to cover the interest and costs because they would not have received payment for interest and costs from the owner. The defendants also argued that it would be impractical for the trust obligation to cover interest and costs because the trustee would not know the amount of the interest and cost claims at the time it received the trust funds. As a result, it could not know how much money it must hold in trust.

The plaintiff countered that this restrictive interpretation of CLA section 8(2) was contrary to the purpose of the CLA; namely, to protect subcontractors and other construction industry participants lower down in the construction pyramid. If this restrictive interpretation were applied, DF would likely have no ability to recover the \$700,000 owing in interest and costs since Gottardo had been adjudged bankrupt.

The Court refused to determine whether interest and costs were subject to the trust obligations because the law was not settled. As a result, it held that it was not appropriate to make a ruling in a summary proceeding and without having the benefit of the full trial process. As a result, we can expect that this issue will be addressed if this case proceeds to trial.

Maximizing Subcontractors' Chances of Recovering Interest and Costs

While the Court did not resolve the question of whether interest and costs can be recovered through a breach of trust claim, it did provide some guidance on how a subcontractor can improve its odds of doing so. The Court referenced the case *Forest City Fire Protection Ltd. v. 1099516 Ontario Inc.* ("**Forest City**"),^[3] where the Court granted summary judgment including interest and costs in a breach of trust claim. The Court in *Deep Foundations* explained this decision by noting that in *Forest City* the subcontract expressly provided for payment of costs and interest. This suggests that interest and costs may be recoverable where the subcontract expressly provides for it, while it may not be recoverable where the subcontract does not. As such, subcontractors should ensure that their subcontracts include provisions for interest and costs.

by Laura Brazil

[1] 2016 ONSC 6245 ("Deep Foundations").

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

[3] 2015 ONSC 2346.

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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