owner, contractor, or subcontractor would remain impressed with the trust and would remain available for payment once a trust claimant obtained a favourable judgment in its breach of trust action.

Going Forward

Several provincial builders' and construction lien statutes in Canada provide for both a trust and lien remedies. Simply put, had the case related to the statute in any of those provinces, the result would have been the same regardless of some minor differences between the statutes. For example, one of the indicia that was used by the S.C.C. to decide that the remedies are separate is that claimants in Manitoba can join a breach of trust claim with their lien action. In Ontario, however, a lien claimant can only join a breach of contract claim with its lien action and must commence a separate trust action. This difference between Ontario and Manitoba would not have changed the result had the case been argued under Ontario law.

A more interesting question relates to the amount of cash security that should be paid into court to extinguish a breach of trust claim. The S.C.C. indicated that had the security paid into court been cash security, the breach of trust remedy would have been unnecessary. However, two issues arise. First, the order paying or filing the cash security with the court would have to indicate that the security was not only for the lien but also for the breach of trust claim. Second, the S.C.C. did not indicate the amount of cash security that should be posted to extinguish the breach of trust claim. Structal's claim consisted of three discrete amounts. Presumably, to extinguish the breach of trust claim, Dominion would have had to pay cash security into court for the invoices and the holdback but not for the delay claim. That would then permit Dominion to file a lien bond for the delay claim of Structal.

Third, had a project bank account been utilized, the cash for the Structal invoices and holdback would be in the project bank account and available to pay into the court. The S.C.C. refers to a contractor posting a lien bond "while still holding trust funds". This appears to be the rationale for the statement that "so long as the trust funds themselves are deposited with the court, the funds are secure and the trust has not been breached". This statement, however, does not take into account the fact that there is no requirement in the builders' and construction lien statutes that an owner or contractor pay trust funds into court, nor do they give trust claimants the opportunity to seek an order compelling an owner or contractor to do so. Furthermore, a contractor paying cash security into court may increase its overall liability, as one could argue that cash security paid into court is converted into trust funds, even though the contractor may have used funds other than project funds to pay into court. For a contractor to avoid this liability creep, the use of a project bank account would clearly identify where the funds came from and their use.

Supreme Court of Canada

Rothstein J., McLachlin C.J., Cromwell, Moldaver, Wagner, Gascon and Côté JJ.
September 18, 2015

CASE SUMMARY

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COURT OF APPEAL PULLS RUG OUT FROM UNDER FRAUDSTERS

Ottawa Community Housing Corp. v. Foustanellas

In 2005, David A. Loveridge started a new job as the Director of Project Implementation and Asset Management for the Ottawa Community Housing Corporation, a low-income social housing provider with over 15,000 units in Ottawa. As his first order of business, Mr. Loveridge set out to assess OCHC's existing corporate assets, including service contracts, and stumbled upon invoices from a

contract with Argos Carpets for supply and installation of carpeting in all OCHC's housing units. He noted that the contract required OCHC to provide Argos with floorplans of any units needing new carpeting. Unfortunately, OCHC did not have floor plans for their units. Mr. Loveridge worried that without floor plans OCHC could not accurately review and approve Argos' invoices.

Mr. Loveridge had his employees take measurements of a number of OCHC's units and compared these measurements against the invoices of Argos. In what became the tip of the iceberg, he found evidence that Argos consistently falsified the floor area of the units to inflate the amounts invoiced to OCHC. On April 26, 2006, Mr. Loveridge informed an Argos' salesperson that, "I think we have a problem here".

How the Trouble Started

Following the OCHC's tender call for a one-year contract for the supply and installation of carpeting and underpad for its social housing projects, Argos submitted a competitive bid in July 2004. The low bid of $11.15 per square yard of carpet and underpad, prepared by Peter Foustanellas, the founder and president of Argos, and his salesperson Mr. Grimes, fell far below the bids of the other four bidders. OCHC selected Argos's bid and entered into a one-year contract with Argos on July 23, 2004.

Among other things, the Contract provided as follows:

- There was an option for two one-year renewals by mutual agreement.
- OCHC was to provide Argos with a floor plan of the units.
- Argos would charge OCHC only for carpet and underpad actually installed, not any waste carpeting.
- Argos would provide a specific quality of carpet noted as "28 oz. pile weight polypropylene level loop carpet".
- Argos would install it to conform to the Canadian Carpet Institute and Carpet and Rug Institute standards.

OHCH never provided Argos with floor plans for each unit; but Argos installed the carpet, and OCHC never questioned the quality or quantity of the carpeting.

Fudging the Numbers

OCHC never should have trusted Argos to invoice only for the carpet and underpad that was actually installed. As OCHC had determined by May 2006, Mr. Grimes fudged the square footage of carpet on the invoices and charged not for the quantity of carpet installed but for the quantity of carpet that would increase Argos' profit to the 25 per cent–50 per cent range. Mr. Foustanellas refused to allow Mr.Grimes, or any other salesperson, to issue an invoice that would generate below 20 per cent profit.

On May 25, 2006, OCHC sent a letter to Mr. Foustanellas stating:

> In light of the foregoing, OCHC has decided to take all of the remaining work out of the hands of Argos Carpets and Flooring pursuant to Article 1.6.1 […] This decision takes effect immediately; the present letter is your formal notice of the same.

Following the letter OCHC stopped issuing work orders to Argos and withheld payment of all outstanding invoices amounting to $141,724.55.

The Trial

In December 2006, Argos sued OCHC claiming the $141,724.55 outstanding for work completed and invoiced. In response, OCHC sued Argos, Mr. Foustanellas, and Mr. Grimes for the overbilling practices Argos engaged in during the contract. The two actions were consolidated, and the trial commenced.

With Whom Was OCHC Doing Business?

Normally, OCHC would not be able to sue employees of a corporation personally for a breach of contract of the business. However, an individual can be personally liable if he or she fails to disclose that they are acting on behalf of a corporation. In this case, Mr. Foustanellas and Mr. Grimes failed to make it clear that they were working on behalf of Argos. Throughout the two-year contract Argos delivered only four documents with the correct corporate name "Argos Carpets Ltd." on them. None of these made their way into the hands of

any manager at OCHC. Further, because Argos subcontracted out all the installation work, there were no uniformed employees or trucks with Argos Carpets Ltd. displayed to alert OCHC. The court found that OCHC did not know that Argos was an incorporated business and could therefore sue Mr. Grimes and Mr. Foustanellas personally.

No Floor Plans—No Problem

Argos contended that the failure to provide floor plans, as required under the contract, meant that OCHC breached the contract first and should therefore not be able to rely on it to sue for breach of contract. The trial court did not accept this argument, finding that the requirement to provide floor plans was not an essential or core obligation of the contract. Further, with the help of expert witnesses, the court determined that floor plans would not have helped Argos install the carpets or determine the price, as a competent carpet installer would have to measure the units anyways before ordering the material and installing. In fact, Argos' carpet installers did measure each unit prior to ordering and installing any carpeting. Argos' carpet installers' correct measurements were actually provided to Argos, but Argos never shared this information with OCHC.

The "Stop the Bleeding" Clause

At trial, Argos tried to rely on the following contract clause:

> Except in the case of insolvency, where any or all of the work has been taken out of the hands of the Contractor, the Contractor will not be entitled to any further payment, including payments then due and payable but not paid.

Argos argued that this clause operated as a "penalty" or "liquidated damages provision". Such provisions, commonly included in construction contracts, either set a sum or create a formula to determine a sum that can be accepted in lieu of a claim for general damages for breach of contract. Argos contended that in withholding the $141,724.55 owing to Argos, OCHC had chosen to accept that sum as the measure of damages and was precluded from making a claim for breach of contract or fraud. The court found that the clause was neither a penalty nor liquidated damages clause, because it did not provide a fixed sum or formula to calculate damages. A penalty or liquidated damages provision cannot depend solely on the value of outstanding invoices.

The trial judge described the clause as a "Stop the Bleeding" clause, which allowed the Owner to stop payments upon the default of the Contractor. On appeal, the Court clarified that the ability to stop payments came about only because OCHC provided formal notice under the contract of the overbilling and terminated the contract. The above clause then allowed OCHC to keep any money owed to Argos *until* the court determined if, and how much, Argos owed under the contract. In effect, the "Stop the Bleeding" clause allowed OCHC to retain the money they owed to Argos as security for their lawsuit.

The Cost of Overbilling—Damages

The evidence of the fraudulent scheme that Argos engaged in to increase their profits was overwhelming. Argos prepared and retained two sets of invoices. One set was used for ordering materials and included accurate measurements of the carpeting required for the units. The second set contained fake measurements, showing much larger square yardage of carpeting required for the unit. With the two sets of invoices side-by-side, Justice Rutherford was able to easily determine that, over the two-year period of the contract, Argos overcharged OCHC by $282,069.10. However, the damages did not stop there.

Much of the carpeting Argos provided was improperly installed and of a lower-grade than required under the contract. Further, Argos invoiced for all carpeting actually used, even waste and off-cuts, contrary to the contract. The Court found that approximately 25 per cent of the actual carpet charged for was waste or off-cut carpeting. He also found that the poor quality installation and materials resulted in at least a 20 per cent reduction in the value of the work. These further breaches resulted in general damages of $633,844.65.

Punitive damages are awarded only in exceptional cases for malicious, oppressive, or high-handed misconduct that offends the court's sense of decency. They are designed to punish the wrongdoer and discourage others from engaging in similar

behaviour in the future. Defrauding a social housing company out of half a million dollars over two years qualified as behaviour worth condemning. As well, the fraudulently low bid of Argos kept its competitors from contracting with OCHC and injured the competition in the marketplace. For these transgressions the trial court ordered $250,000 in punitive damages against Mr. Grimes, Mr. Foustanellas, and Argos. However, on appeal, the court ruled that the trial judge made an error in ordering punitive damages against all the fraudsters. Punitive damages arise from the misconduct of a particular individual, and as such the damages have to be ordered solely against the individual. Citing the objectives of punishment, deterrence and denunciation, the Court of Appeal ruled that awarding the punitive damages solely against Mr. Foustanellas best advanced the objectives.

Costs

OCHC incurred a total of $660,586.36 in legal fees. The typical measure of damages is on a "partial or substantial indemnity scale", between 60 per cent and 90 per cent of the legal fees incurred. However, sometimes, the court can order payment of costs on a "full indemnity scale", meaning that the losing party pays the entirety of the other side's legal fees. Full indemnity is awarded only in a rare or exceptional case where the losing party engaged in reprehensible conduct either in their actions before the lawsuit or during the lawsuit. In this case the fraud Argos engaged in was of such a magnitude that awarding the full legal fees of OCHC was necessary.

An application for leave to appeal to the Supreme Court of Canada was filed August 5, 2015.

Ontario Court of Appeal

Cronk, Pepall, Benotto JJ.A.
April 21, 2015

CASE SUMMARY

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NOTICE OF A LABOUR AND MATERIAL PAYMENT BOND: WHO TAKES THE INITIATIVE?

Valard Construction Ltd. v. Bird Construction Co.

The Alberta Court of Queen's Bench decision of *Valard Construction Ltd. v. Bird Construction Co.* helps clarify the duty of an obligee/trustee under a labour and material payment bond to provide subcontractors with notice of the bond's existence. The decision portends bad news for those who attempt to claim on a bond after the timely notice period but good news for obligee/trustees, who are not required to freely offer up information as to the existence of the bond unless that information is requested of them. Thus, this decision is necessary reading for anyone working on a project where a bond might exist, and it emphasizes the importance of always inquiring as to whether one does.

The defendant and general contractor in this matter was Bird Construction Company, who entered into a contract with Suncor Energy. Bird entered into a subcontract with Langford Electric Ltd. to perform the electrical work on a project. One condition of the subcontract required Langford to obtain a labour and material payment bond. The bond was issued by the Guarantee Company of North America (GCNA) in the amount of $659,671 and was a standard CCDC 222-2002 bond. Langford also entered into a subcontract with the plaintiff, Valard Construction Ltd., to perform services such as directional drilling.