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Ontario Court of Appeal Addresses Use of Fresh Evidence in Obtaining a Declaration that Judgment Debt Survives Bankruptcy

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By Philip Cho

In a recent decision, the Ontario Court of Appeal approved the use of "fresh" evidence in obtaining a declaration that a judgment debt for statutory breach of trust survives bankruptcy. In the case of *Yanic Dufresne Excavation Inc. v. Saint Joseph Developments Ltd.,* 2022 ONCA 556 ("***Yanic***"), the Court of Appeal reviews some best practices for obtaining a declaration under s. 178 of the *Bankruptcy and Insolvency Act* ("**BIA**") where the bankruptcy occurs after judgment and highlights the importance of pleading sufficient facts to support an s. 178 declaration.

The Court of Appeal considered an appeal from the decision of Justice Kershman granting the plaintiff's cross-motion to vary the default judgment against one of the individual defendants, Albert Plant ("**Plant**"). The reasons for decision in the motion below will be of interest, particularly to those in the construction law bar, as it also provides a thorough review of the nature of evidence and factors to support a breach of trust claim against a director pursuant to s. 13 of the *Construction Act*. However, I want to focus on the procedure that led to Justice Kershman's decision which the Court of Appeal upheld.

Procedural History & Superior Court Decision

The plaintiff was an excavation company retained by one of the defendant corporations of which Plant was a director and officer. The plaintiff obtained default judgment against the defendants, including Plant, on a motion for default judgment before Justice Kane. As is the accepted practice, the default judgment did not include any declaratory relief that the judgment survives bankruptcy because at the time, Plant was not bankrupt. Less than one month after the issuance of the default judgment, Plant made an assignment in bankruptcy.

The plaintiff advised the trustee in bankruptcy that it would be seeking to obtain a declaration that the judgment debt as against Plant survives bankruptcy. Under s. 178 of the BIA, certain types of debts are not affected by a bankruptcy, including, for example, fines or penalties, spousal or child support, student loans, and of significance in this case, a debt arising out of "fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity."

Upon learning that the plaintiff sought a declaration that the judgment debt survives bankruptcy, Plant brought a motion to set aside the default judgment and, as required, swore an affidavit providing evidence to support a defence on the merits. Plant was also cross-examined on his affidavit. At a case conference, the parties agreed to permit the plaintiff to first bring and argue a cross-motion to vary the default judgment to include a declaration that the debt survives bankruptcy. The parties agreed that the cross-motion could proceed first because if the plaintiff's cross-motion were denied, then Plant's motion to set aside default judgment would no longer be necessary (because of the bankruptcy).

The plaintiff's cross-motion to vary was brought under Rule 59.06(2), which provides that: "A party who seeks to, (a) have an order set aside or varied on the ground of fraud or of facts arising or discovered after it was made… may make a motion in the proceeding for the relief claimed." On the motion, Justice Kershman admitted and considered evidence from Plant's affidavit in support of his motion to set aside default judgment, as well as evidence from his cross-examination. Being satisfied that this evidence supported a finding that the debt arose out of misappropriation while acting in a fiduciary capacity, Justice Kershman granted the order varying the default judgment to declare that it survived bankruptcy (as against Plant).

The Appeal

Plant appealed this decision on three grounds of appeal, including that the motion judge erred by admitting and relying upon extrinsic evidence to make fresh findings of fact and that the statement of claim was not particularized to ground the finding of misappropriation while acting in a fiduciary capacity. The Court of Appeal dismissed the appeal.

In coming to its decision, the Court of Appeal clarified the use of "fresh" evidence in seeking a s. 178 declaration after a judgment has been issued. Plant relied on a prior decision of the Court of Appeal in *Lawyers' Professional Indemnity Company v. Rodriguez,* 2018 ONCA 171 ("***Rodriguez***"), for the principle that an applicant seeking a s. 178 declaration cannot rely on previously unmade allegations against the judgment debtor that they engaged in additional wrongs. As such, the application judge is confined during a s. 178 application to evidence "grounded in the process that produced the judgment debt". While the application judge can look to the entire context of the proceedings that produced the judgment, including all of the material filed that led to the judgment, any other evidence is "extrinsic" and inadmissible on a s. 178 application.

The Court of Appeal distinguished between simply seeking a declaration pursuant s. 178 of the BIA, and a motion pursuant to Rule 59.06 to vary an order, which expressly refers to fresh evidence or facts. As such, the rule in *Rodriguez* is not applicable to a Rule 59.02 motion to vary. Moreover, the Court of Appeal agreed with the motion judge that the new evidence could not have been discovered with reasonable diligence because Plant did not defend the action and as such, no discovery was available to the plaintiff. Accordingly, principles of *res judicata* were not triggered by the consideration of fresh evidence.

On a motion to vary under Rule 59.06, the scope of evidence is circumscribed by the pleadings. The Rule "does not contemplate altering a judgment or order to provide for relief never sought in the moving party's pleading" (See: *Royal Bank of Canada v. Korman,* 2010 ONCA 63, at para. 24). As such, another ground of Plant's appeal was that the pleadings did not sufficiently plead with particularity to support a finding of misappropriation while acting in a fiduciary capacity. Recall that under Rule 25.06(8), when pleading fraud or breach of trust, "the pleading shall contain full particulars…"

While a pleading is not required to expressly refer to s. 178 of the BIA (which is sensible given that the defendant would normally not be bankrupt at the time), the material facts to support a finding that the substance of the debt is one that falls under s. 178 must be pleaded. In *Yanic,* the plaintiff's pleading contained sufficient allegations of material facts, including that:

- the corporate defendant received amounts that constituted trust funds for the benefit of the plaintiff;
- at all material times, Plant had effective control of the corporate defendant;
- Plant was acting in a fiduciary capacity
- some of the trust funds were appropriated and converted by the corporate defendant;
- Plant assented to and acquiesced in the appropriation and conversion of funds; and,
- Plant dishonestly and improperly appropriated or converted the funds to his own use.

As such, the Court of Appeal found that the pleadings, as a whole, sufficiently suggested fraudulent conduct for the purposes of s. 178 of the BIA.

Takeaways

It is well-established that a court will not grant a declaration that a debt falls under s. 178 of the BIA and survives bankruptcy prior to a bankruptcy. However, one should plead the facts (where known) that support the characterization of the debt as one falling under s. 178 of the BIA. Additional evidence to support the facts may be discovered later, but if such facts are not pleaded in the first instance, then one may be unable to vary a default judgment following a bankruptcy. Amending the pleading to advance a new cause of action would likely result in the plaintiff being unable to rely on the default judgment, allowing the defendant to defend the claim.

Yanic reinforces the appropriateness of pleading facts, where appropriate, that will support a declaration under s. 178 of the BIA without specifically seeking such relief prior to a bankruptcy. *Yanic* also endorses using Rule 59.06(2) as an alternate, or complimentary route, to obtaining declaratory relief that a debt survives bankruptcy. In the right circumstances, using Rule 59.02(6) will permit the tendering of fresh evidence and avoid the rule in *Rodriguez*.

The information and comments herein are for the general information of the reader and are not intended as advice or opinion to be relied upon in relation to any particular circumstances. For particular application of the law to specific situations, the reader should seek professional advice.

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