

Housing construction project turned sour results in personal liability and dismissal of defamation claim

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28 December 2020

Although building a house can take much planning and hard work in securing a developer, labour and material, it is meant to be a joyous exercise which ultimately culminates in the creation of living space that is expected to meet a homeowner's dreams and desires. But not all home building projects turn out as planned and some times, like in the recent Alberta case of *Zerbin v. Vrbanek*, 2020 ABQB 797, they end up in court with allegations being made by both sides to the dispute regarding the failure to complete the project. In *Zerbin*, a number of issues arose, but for the purposes of this blog only two of the issues determined by the court will be discussed in this case of a housing construction project that turned sour. Those issues relate to when can a court impose personal liability against a director or officer of a company and to the application of defences of truth or justification and qualified privilege in a defamation action.

Background to the action

The Zerbins were residential property owners. They wanted to build a dream house, and accordingly engaged a development company operated by the individual defendant, Mr. Vrbanek. While the Zerbins' dream home was being built, they engaged the same company to build a second home on a smaller lot which they owned. The second house was intended to be a gift for their daughter and son-in-law.

However, before both houses were completed, the Zerbins terminated their construction contracts with the company because they had learned from a cabinetry and tile supplier used in the construction project that the development company had been inflating invoices, not paying sub-trades and had taken a kickback from the supplier in the amount of \$35,000. The allegation about the kickback in particular triggered a series of events which ultimately led to the Zerbins terminating the development contracts, an action for damages against the development company and Mr. Vrbanek, and a counterclaim in which among other things, the development company sought damages for defamation against the cabinetry and tile supplier and the homeowners in connection with comments made in emails between the supplier and the homeowners.

With respect to the action for damages, the Zerbins contended that the individual owner, director and officer of the development company be held personally liable.

With respect to the defamation claim made by the development company, the supplier and homeowners defended on the grounds that the alleged defamatory comments either represented the truth or were protected by qualified privilege. The emails, which were exchanged over a 9-day period, disclosed, among other things, that the development company had asked the supplier to add 2% to the supplier's prices and asked for a \$35,000 kickback, and included uncomplimentary statements made by the supplier about the individual behind the development company.

Basic findings of the Court

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In a lengthy decision, the Court found that the Zerbins were justified in terminating their contracts with the development company. The evidence showed that those contracts were expired at the time of termination and that, in any event, those contracts had been breached as a result of the dishonest conduct of the development company. The development company had wrongly overcharged the Zerbins by over \$1.4 million Canadian and nearly \$40,000 U.S. and had wrongly retained an additional \$171,000 Canadian and \$39,000 U.S., which were said to have been paid to trades and suppliers, but actually were not paid.

The Court found at paragraph 133 that based on the terms of the contracts, the development company had viewed the two contracts as an enduring source of revenue or a “cash cow”. The development company had financial problems and the two projects were being used to keep the company afloat.

Personal liability against owner, director and officer of development company

But the development company had closed following the termination of the contracts. So the Zerbins wanted the award of the damages to be made personally against the sole director and officer and owner of the development company, Mr. Vrbaneck. The Zerbins contended that personal liability could be awarded under either (i) fraud and equitable fraud; (ii) lifting the corporate veil; or (iii) constructive trust, based on agency.

Justice Mah found that there was personal liability based on fraud and equitable fraud and based on the doctrine of lifting the corporate veil.

With respect to the fraud and equitable fraud, the Court described that in the civil context, fraud was either the tort of civil fraud or deceit. To establish a civil fraud, the Supreme Court of Canada had held in *Bruno Appliance and Furniture Inc. v. Hryniak*, 2014 SCC 8 at paragraph 21 that the following four elements needed to be proven:

1. a false representation made by the defendant;
2. some level of knowledge of the falsehood of the representation on the part of the defendant (whether through knowledge or recklessness);
3. the false representation caused the plaintiff to act; and
4. the plaintiff's actions resulted in a loss.

Mr. Vrbaneck contended that he had no intention to deceive the Zerbins or to cause them a loss and therefore the requirement of a false representation was not met. His evidence at trial was that he had planned to do a reconciliation of what was actually owed at the end of the contracts.

But the court noted that the ongoing relevance of the intention requirement was uncertain based on *Precision Drilling Canada Limited Partnership v. Yangarra Resources Ltd.*, 2017 ABCA 378 and *Singh v. Trump*, 2016 ONCA 747 and that in this case the contracts had been dishonestly performed, that the Zerbins had been overcharged and that the money paid had been used by both the development company and Mr. Vrbaneck for their own purposes. As well, Mr. Vrbaneck was unable to explain the fact that some documents had been forged, and that there were false deposits and reversed payables, which suggested deceit.

As the directing mind of the development company, Mr. Vrbaneck had knowledge that there was overcharging on invoices and that money which had been paid was directed for uses not intended by the Zerbins.

Accordingly since “the facts invoke[d] fraud, deceit or dishonesty”. Mr. Vrbaneck was held personally liable for the losses.

In the alternative, Justice Mah pierced the corporate veil based on the application of the test established in *Transamerica Life Assurance Co. of Canada v. Canada Life Assurance Co.*, (1996), 28 O.R. (3d) 423 (Gen. Div.), aff'd [1997] O.J. No. 3754 (C.A.). Under this test, which had been adopted in Alberta, a corporate veil can be pierced where:

1. the individual exercises complete control of finances, policy, and business practices of the company;
2. that control must have been used by the individual to commit fraud or wrong that would unjustly deprive a claimant of his or her rights; and
3. the misconduct must be the reason for the third party's injury or loss.

Justice Mah held at paragraph 163 that Mr. Vrbaneck exercised complete control and authority over the development company's finances, policy and business practices, that control and authority was exercised by Mr. Vrbaneck in a deceitful manner that deprived the Zerbins of their money, and that this misconduct was the exact cause of the Zerbins' loss.

Defamation action against supplier and homeowners dismissed

With respect to defamation, Justice Mah dismissed the counterclaim based on the defences of truth or justification and qualified privilege.

In order for a defamation action to succeed, a claimant must first establish that the following:

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- that the impugned words were defamatory, in the sense that they would tend to lower the plaintiff's reputation in the eyes of a reasonable person;
- that the words in fact referred to the plaintiff; and
- that the words were published, meaning that they were communicated to at least one person other than the plaintiff.

These necessary elements were recognized by the Supreme Court of Canada in the seminal case of *Grant v. Torstar Corp.*, 2009 SCC 61 at paragraph 28.

Once these elements are established, the burden shifts to the commentator to advance defences that nullify liability.

Here the court found that the words exchanged in the emails were defamatory because they accused the development company and Mr. Vrbaneck of engaging in illegal or unscrupulous business practices, that the development company was insolvent, and that Mr. Vrbaneck was deceptive and dishonest.

However, there was truth to the comments made in the emails. Truth or justification is an absolute defence and is satisfied where the substance of the allegations are justified. In *Jiang v. Sing Tao Daily*, 2014 ONSC 287, the court at paragraph 46 explains that the test is substantial truth and that it is not necessary to prove the truth of every word.

The truth in this case was that Mr. Vrbaneck and the development company did engage in illegal and unscrupulous business practices, that he tried to “cover his tracks”, that the development company owed money to various trades, that Mr. Vrbaneck was deceptive and that the development company was insolvent at the time the comments were made.

But one of the comments did not come within the defence of truth or justification and therefore the defence of qualified privilege needed to be considered. The supplier and one of the homeowners had each commented that Mr. Vrbaneck was planning to leave town with the Zerbins' money.

The defence of qualified privilege applies where a commentator has a legal, public or social duty to make the comment, and the recipient of the comment has a corresponding duty or interest in receiving it: *Hill v. Church of Scientology of Toronto*, 1995 CanLII 59.

The defence of qualified privilege, however, will be defeated where the dominant purpose of the comment is malice or, in other words, made to injure the person identified by the comment.

The defence applied in this case because the supplier had a duty to inform the Zerbins of his concerns about kickbacks and that the motivation behind the communications was that the supplier felt uncomfortable with had been taking place. Thus even though the comment about Mr. Vrbaneck “skipping town” was untrue, it was nevertheless protected by the occasion of the communications between the supplier and the homeowner.

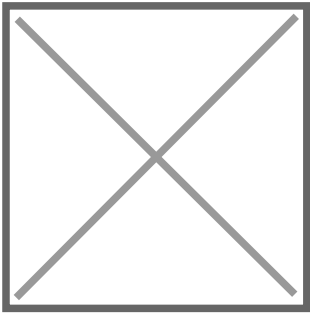
Conclusion

Parties to a contract must perform their part of the bargain with honesty. In circumstances where there is dishonest performance a contract can be terminated. Where the dishonest performance is made by a corporation, this can lead to personal liability on the part of a director or officer or owner, especially in a solely owned corporation. As well, those allegations of dishonesty will not necessarily result in defamation. Even though, as the Zerbins case shows, the allegations might meet the test for bringing a defamation claim, those allegations can be protected by the defences that apply to a defamation action.

If you require any litigation assistance, our **Dispute Resolution Group** lawyers are available to assist you. Please contact **Stephen Thiele** at 416.865.6651.

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