COURT FILE NO./ ESTATE NO.	25-1475756 25-1475756	Clerk's Stamp
COURT	COURT OF QUEEN'S BENCH OF ALBERTA IN BANKRUPTCY AND INSOLVENCY	BANKRUPTCY AND INSOLVENCY FAILUTE ET INSOLVABILITE AUG 3 - 2012 CALGARY, ALBERTA
JUDICIAL CENTRE	CALGARY	
	IN THE MATTER OF THE BANKRUPTCY OF IONA CONTRACTORS LTD.	
APPLICANT	ERNST & YOUNG INC., in its capacity as Receiver and Manager, and Trustee in Bankruptcy, of IONA CONTRACTORS LTD.	
RESPONDENT	THE GUARANTEE COMPANY OF NORTH AMERICA	
DOCUMENT	**BRIEF AND AUTHORITIES**	
ADDRESS FOR SERVICE AND CONTACT INFORMATION OF PARTY FILING THIS DOCUMENT	Norton Rose Canada LLP 400 3rd Avenue SW, Suite 3700 Calgary, Alberta T2P 4H2 Phone: +1 403.267.8222 Fax: +1 403.264.5973 Attention: Howard A. Gorman / Kyle D. Kashuba File No. 269971	

I. INTRODUCTION

1. Ernst & Young Inc. in its capacity as receiver and manger, and trustee in bankruptcy, of Iona Contractors Ltd. ("**Iona**") seeks an Order of this Honourable Court directing that the holdback funds in the amount of $997,716.00 plus interest if any (the "**Funds**") currently being held by The Guarantee Company of North America ("**GCNA**"), on behalf of Calgary Airport Authority ("**Airport**"), be released to Ernst & Young Inc. to be distributed to the entitled proven creditors of Iona.

II. FACTUAL BACKGROUND

2. Alberta Treasury Branches ("**ATB**") and Iona executed a commitment letter dated August 9, 2010 (the "**Commitment Letter**"), that amended and restated pre-existing commitment letters between ATB and Iona, under which ATB agreed to make certain credit facilities available to Iona.

Affidavit of Robert J. Taylor sworn August 3, 2012 (the "**Taylor Affidavit**") at paragraph 11

3. As security for repayment of the amounts owing under the Commitment Letter, ATB maintained, among other things, a General Security Agreement ("**GSA**") from Iona dated May 13, 2008.

Taylor Affidavit at paragraph 12

4. ATB had registered a financing statement perfecting the GSA against Iona on May 16, 2008.

Taylor Affidavit at paragraph 13

5. On December 14, 2010, Iona together with a number of related companies (collectively the "**Envision Group**") made an initial application for protection under the *Companies' Creditors Arrangement Act*, RSC 1985, c C-36, as amended ("**CCAA**") in the Ontario Superior Court of Justice ("**Ontario Court**"). RSM Richter Inc., a predecessor to Ernst & Young Inc. (together, RSM Richter Inc. and Ernst & Young Inc. are referred to herein as "**E&Y**") was appointed the Monitor in the CCAA proceeding. At the time of its application for CCAA protection, the evidence before the Court was that the Envision Group had a total amount of claims against it in excess of $35,000,000.00.

Taylor Affidavit at paragraphs 2 and 3

6. ATB held and maintained security over all of Iona's present and after acquired personal property under the GSA. An Alberta Personal Property Registry search dated July 13, 2012, in respect of Iona references that the Respondent, GCNA, registered a financing statement against Iona dated December 14, 2010.

Taylor Affidavit at paragraph 14

7. The Ontario Court refused a request to further extend the CCAA stay of proceedings at an application held January 14, 2011.

Taylor Affidavit at paragraph 4

8. On January 14, 2011, ATB privately appointed E&Y as receiver and manager (the "**Receiver**") over the assets and undertakings of Iona.

Taylor Affidavit at paragraph 5

9. E&Y, as Receiver, with the assistance of its legal counsel, determined that:

   (a) ATB's security over all of the property of Iona is good, validly registered and perfected;

   (b) ATB is owed approximately $6,400,000.00; and

   (c) ATB will likely suffer a significant shortfall on its loans advanced.

Taylor Affidavit at paragraph 15

10. After discussions between Iona and the Receiver, Iona filed an assignment in bankruptcy on March 16, 2011, which was accepted by the Official Receiver on March 18, 2011. By the Certificate of Appointment, E&Y was also appointed trustee in bankruptcy (the "**Trustee**") over Iona.

Taylor Affidavit at paragraph 6

11. ATB's security over all of the property of Iona is good, validly registered and perfected.

Taylor Affidavit at paragraph 15

12. At the time of the commencement of the CCAA proceeding, the Airport held funds in the approximate amount of $997,716.00, in respect of work that was performed and materials that were supplied to the Airport by Iona, involving a project described as 2009 North Airfield Improvements Contract P2009-1012, Taxiway W Relocation, Apron 1 Expansion, Taxiway C2 Relocation and Taxiway A / Runway 16 Threshold Widening (the "**Airport Project**").

Taylor Affidavit at paragraph 7

13. The Airport Project was a bonded project. Iona, as principal, and GCNA, as surety, entered into a Labour and Material Payment Bond on May 25, 2009.

Taylor Affidavit at paragraph 8

14. By way of an agreement between the Airport, GCNA and the Trustee, in the course of the Iona bankruptcy and receivership proceedings, the Airport provided the Funds, in trust, to counsel to GCNA, for distribution pending the determination of entitlement to the same as between GCNA and ATB.

Taylor Affidavit at paragraph 10

15. ATB claims entitlement to the Funds pursuant to its security, including the GSA.

16. GCNA has made a claim to the Funds pursuant to the terms of the Labour and Material Payment Bond provided to Iona by GCNA.

17. E&Y, in its capacity as Receiver and Trustee, has brought this Application to have the entitlement to funds determined by this Court.

II. ISSUE

18. E&Y, in its capacity as Receiver and Trustee, respectfully requests that this Honourable Court hear and determine the following issue:

    (a) should the Funds be released to GCNA as the assignee of the rights of the subcontractors on the Airport project, or to E&Y, as Receiver and Trustee, for distribution to the creditor/ creditors of Iona with proven claims in the Iona bankruptcy?

III. LEGAL ANALYSIS

A. Who has the best claim to the Funds?

(i) The Bankruptcy Proceedings

19. The Receiver / Trustee has concluded that ATB has the best claim to the Funds. It is further submitted that the Funds should be released by GCNA to E&Y and distributed to the priority creditor/creditors in accordance with the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3 ("**BIA**").

20. Upon the Iona private receivership appointment dated January 14, 2011, E&Y was appointed receiver and manager, without security, of all of Iona's current and future assets, undertakings and properties of every nature and kind whatsoever, and wherever situate, including all proceeds receipts and disbursements arising out of Iona's property.

Taylor Affidavit at paragraph 5

21. Further, upon the subsequent March 16, 2011 bankruptcy, the entirety of Iona's interest in the Funds vested in the Trustee, irrespective of the terms of the contract between Iona and the Airport, of which ATB is not a party.

Taylor Affidavit at paragraph 7

(ii) *A.N. Bail Co. v Gingras* and *Horizon Earthworks*

22. The Trustee's submission that ATB has the best claim to the Funds is supported by the Supreme Court of Canada decision in *A. N. Bail Co. v Gingras.* The facts in this case are, in the Trustee's submission, comparable to those at issue in the case at bar.

Tab 1
A. N. Bail Co. v Gingras [1982] 2 SCR 475 ("***A.N. Bail***")

23. The facts of the *A.N. Bail* case are not uncomplicated. In *A.N. Bail*, Defence Construction (1951) Ltd. ("**DCI**") (as agent for Her Majesty the Queen) entered into a design and construction contract (the "**Head Contract**") with A.N. Bail Co. ("**A.N. Bail**"). Clause 21 of the Head Contract stated s follows:

> 21. (1) Her Majesty may, in order to discharge lawful obligations of and satisfy lawful claims against the Contractor [A.N. Bail] or subcontractor arising out of the execution of the work, pay any amount which is due and payable to the Contractor pursuant to the Terms of Payment or is payable pursuant to section 41 of the General Conditions following a conversion of a negotiation of the security deposit directly to the obligees of and the claimants against the Contractor or the subcontractor.

24. A. N. Bail then sub-contracted the masonry portion of the Head Contract to Maconnerie Montmorency Inc. ("**MMI**") who subsequently became a bankrupt. Following MMI's bankruptcy, A.N. Bail delivered amounts due and owing by MMI to a supplier of

materials, Tuyaux Vibres Inc. ("**TVI**") (i.e. a creditor of MMI). The facts of the *A .N. Bail* case are comparable to those at issue in that GCNA is proposing, after the commencement of the receivership and bankruptcy proceedings, to direct the Funds to certain of Iona's creditors (i.e. the sub-contractors on the Airport project) to the exclusion of E&Y and the creditors of Iona.

25. The Supreme Court in *A. N. Bail* formulated the issue to be determined as follows:

> ...whether such a contractual clause [Clause 21] can be applied after the bankruptcy, so that the payment made by the appellant to a creditor of a bankrupt company would have the effect of releasing appellant from its obligations to the trustee.

In even simpler terms, the Supreme Court phrased the issue as per the below:

> ...can this clause [Clause 21] be put into effect after the bankruptcy so as to authorize a debtor of the bankrupt company to pay a creditor of the latter instead of the trustee, if it so chooses?

Tab 1
A. N. Bail at paragraphs 10 and 11

26. The Supreme Court in *A.N. Bail* found that Clause 21 could not be applied "so as to supersede the provisions of the Bankruptcy Act". The Court held as follows:

> It would be to disregard the Bankruptcy Act and deprive it of all meaning if the debtor of a bankrupt, instead of paying the trustee, were authorized, by contract or some other means, to pay one or other of the creditors of the bankrupt as he saw fit.

Tab 1
A. N. Bail at paragraph 41

27. The reasoning in *A. N. Bail* applies equally to the circumstances at issue in the case at bar. It would be to completely disregard not only the BIA but also the Iona receivership appointment if the Airport was permitted to deliver the Funds to the sub-contractors to the Airport project to the exclusion of the Trustee and the bankruptcy creditors.

28. This position recently met approval at the Alberta Court of Queen's Bench in *Horizontal Earthworks Ltd. (Re)*. In that case, Horizon Earthworks Ltd. ("**Horizon**"), a road construction operation, was assigned into bankruptcy. There remained a balance owing on its Harper Creek Contract. Sub-contractors and suppliers filed claims against the project owner and against Western Surety, a bonding company with whom Horizon had posted Performance and Labour and Material Bonds. The Owner sought authorization to direct the funds to unpaid sub-contractors and suppliers. In that case, as in the circumstances at issue in the present case, a bank was the first position priority secured creditor.

Tab 2
Horizontal Earthworks Ltd. (Re),
2011 ABQB 799 ("***Horizon Earthworks***")

29. Justice D.R.G. Thomas presented the issue in *Horizon Earthworks* as follows:

> ...is the proposal for the payment of the Harper Creek Funds to unsecured creditors of Horizon which is made by Greenview [Owner] and Western Surety compliant with the scheme of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3 (the "*BIA*") dealing with the priority claims in a bankruptcy, specifically ss. 136 and 141 of the *BIA*?

Tab 2
Horizontal Earthworks at paragraph 33

30. The Court confirmed that, pursuant to ss 136 and 141 of the BIA, secured creditors had priority over unsecured creditors such as the sub-contractors and suppliers. The Court went on to say:

> The clear intent of the *BIA* is to provide for certainty in the resolution of claims. It exists to prevent this sort of private arrangement which would lead to the reordering of priorities by agreement between the interested parties. ...the *BIA* provides a scheme...to bring the administration of the affairs of a bankrupt to a timely and predictable conclusion. This sort of end-run around the legislation which is proposed here should not be and will not be allowed by this Court.

Tab 2
Horizontal Earthworks at paragraphs 39-40

31. The Trustee respectfully submits that the *Horizon Earthworks* case provides further, clear support for the proposition that to permit the Airport, as owner and debtor of Iona's to redirect the debt to Iona's creditors would disregard the legislative scheme set out in the BIA. Specifically, that secured creditors have priority over the claims of the unsecured creditors of a bankrupt entity.

32. Furthermore, a contractual or "private arrangement" which purports to reorder priority is the precise arrangement the BIA is designed to prevent. It is the Trustee's respectful submission that the Airport's proposal undermines the scheme set out in the BIA and the BIA objective to reach timely and predictable settlements of claims against a bankrupt.

(iii) The decisions in *Canadian Commercial Bank, Donald Developments* and *Union Construction*

33. The Trustee, in its consideration, has considered possible contra positions that may be advanced by GCNA.

34. In *Canadian Commercial Bank,* the Court considered a claim under the Saskatchewan builders' lien legislation. The sub-contractors in that case were beneficiaries pursuant to a statutory trust. In contrast, in the circumstances currently before this Court, the Alberta *Builders' Lien Act*, RSA 2000, c B-7 ("***Builders' Lien Act***") has absolutely no application to the claims advanced by the sub-contractors as the work is covered under the *Public Works Act*, RSA 2000, c P-46.

Tab 3
Canadian Commercial Bank v Simmons Drilling Ltd. (1989), 62 DLR (4th) 243 ("***Canadian Commercial Bank***")

35. With respect to the Court's comments at paragraph 8 of *Canadian Commercial Bank*, the Trustee submits that the Court was merely asserting that a Court-appointed receiver and manager has no legal basis to deny a sub-contractor's ability to assert a lien in the course of a receivership proceeding. The Trustee notes that this fact is codified in the Alberta Standard Template Receivership Order, which states as follows:

> **No proceedings against the debtor or the property**
>
> No Proceeding against or in respect of the Debtor or the Property shall be commenced or continued except with the written consent of the Trustee or with leave of this Court and any and all Proceedings currently under way against or in respect of the Debtor or the Property are hereby stayed and suspended pending further Order of this Court, provided, however, that nothing in this Order shall prevent any Person from commencing a proceeding regarding a claim that might otherwise become barred by statute or an existing agreement if such proceeding is not commenced before the expiration of the stay provided by this paragraph 8.

36. The Trustee agrees that an Alberta private or Court-appointed receiver and manager has no basis in law to restrict or bar a contractor from filing a lien in accordance with the time periods prescribed by the *Builders' Lien Act* notwithstanding the commencement of receivership proceedings.

37. Notwithstanding the previous statement, the Court in *Canadian Commercial Bank* notes, in paragraph 15, the difference between a trustee in bankruptcy and a receiver. Specifically, the property of a bankrupt vests in a trustee in bankruptcy while a receiver has only possession of and custody over that property. In *Donald Developments*, it is clear that after the date of bankruptcy the property vests in the trustee and is no longer available to the Owner to satisfy third party claims.

Tab 4
Donald Developments Ltd. v Nova Scotia Power Corp., paragraph 18 [1988] 88 NSR (2d) 336 (NS SC (TD)) ("***Donald Developments***")

38. The *Donald Developments* case supports the position that the holdback funds are payable to the trustee in bankruptcy. In *Donald Developments*, the owner (i.e. Nova Scotia Power) engaged a general contractor, Standard, who later engaged sub-contractors. Upon Standard's bankruptcy, the various sub-contractors sought payment from Nova Scotia Power of amounts it had previously held back from Standard.

39. The Court held that the holdback funds were not impressed with a constructive trust in favour of the sub-contractors. As such, there was no legal connection between the sub-contractors and the Owner. The sub-contractors only recourse was with the bankrupt General Contractor and their claim was neither preferred nor secured. The Court expressly concluded that, "under the provisions of the Bankruptcy Act, the funds were payable to the trustee".

Donald Developments at paragraph 18

40. Finally, the Trustee has considered the *Union Construction* case. In *Union Construction*, the general contractor agreed to a holdback of funds until such time as it satisfied the owner that all sub-contractors had been paid. The general contractor then awarded the contract to Union Construction who proceeded to retain sub-subcontractors.

Tab 5
(Re) Union Construction et al, [1980] 42 NSR (2d) 622
(NS SC (CA)) ("***Union Construction***")

41. Upon Union Construction Limited being placed into receivership, the sub-subcontractors claimed a priority to the holdback amounts being retained by the owner. In the lower Court, it was held that the sub-subcontractors were entitled to the holdback amounts on the basis that they were retained, at the outset, for their protection. On that basis, the holdback amounts were impressed with a trust in favour of the sub-subcontractors.

42. Upon appeal, the Nova Scotia Court of Appeal in *Union Construction* found that the lower Court was in error in finding a constructive trust. In short, the Court of Appeal held that the sub-subcontractors were not entitled to satisfy their claims by resort to the holdback amounts in priority to the secured lenders.

IV. RELIEF SOUGHT

43. E&Y, in its capacity as Receiver and Trustee over Iona, submits that the Funds currently being held by GCNA, on behalf of the Airport, should be released by GCNA's counsel to E&Y.

44. The Funds should to be paid by E&Y to ATB, as ATB has a valid and enforceable first ranking security interest over Iona, and in particular, has priority over GCNA with respect to the Funds.

45. The Trustee seeks the costs of this Application, and interest accrued in respect of the Funds.

ALL OF WHICH IS RESPECTFULLY SUBMITTED THIS 3rd DAY OF AUGUST, 2012.

NORTON ROSE CANADA LLP

Per:_____
Howard A. Gorman / Kyle D. Kashuba
Solicitors for the Applicant,
Ernst & Young Inc. in its capacity as Receiver and Manager, and Trustee in Bankruptcy, of
Iona Contractors Ltd.

TABLE OF AUTHORITIES

1. *A. N. Bail Co. v Gingras*, [1982] 2 SCR 475
2. *Horizontal Earthworks Ltd. (Re)*, 2011 ABQB 799
3. *Canadian Commercial Bank v Simmons Drilling Ltd.*, [1989] 76 CBR (NS) 241 (Sask CA)
4. *Donald Developments Ltd. v Nova Scotia Power Corp.*, [1988] 88 NSR (2d) 336 (NS SC (TD))
5. *(Re) Union Construction et al*, [1980] 42 NSR (2d) 622 (NS SC (CA))

Tab 1

1982 CarswellQue 122, [1982] 2 S.C.R. 475, 54 N.R. 280, J.E. 82-976

1982 CarswellQue 122, [1982] 2 S.C.R. 475, 54 N.R. 280, J.E. 82-976

A.N. Bail Co. v. Gingras

A.N. Bail Co. Ltée, (Defendant-Appellant) Appellant and Paul Gingras and Jacques Gingras, (Plaintiffs-Respondents) Respondents and Mercure Béliveau & Cie, in the capacity of trustee, Respondent in continuance of suit

Supreme Court of Canada

Estey, McIntyre, Chouinard, Lamer and Wilson JJ.

Judgment: June 16, 1982
Judgment: September 28, 1982
Docket: 16265

Proceedings: On appeal from the Court of Appeal for Quebec

Counsel: *Normand Amyot*, for the appellant.

Francine Côté and *Laurent Trudeau*, for the respondent trustee.

Subject: Corporate and Commercial; Property; Insolvency

Bankruptcy --- Property of bankrupt — Choses in action — Debts owing to bankrupt.

Trustee claiming from appellant balance owing under subcontract between bankrupt company and appellant — Appellant paying money in dispute to creditor of bankrupt pursuant to contract between appellant and bankrupt — Trustee alleging contractual clause invalid following bankruptcy — Appeal allowed — Clause of contract not supplanting provisions of Act — No legal connection existing between appellant and creditor — Trustee being only individual who could obtain payment of debt — Bankruptcy Act, R.S.C. 1970, c. B-3, ss. 47, 50, 112.

English version of the judgment of the Court delivered by *Chouinard J.*:

1 Respondent, the trustee in bankruptcy of Maçonnerie Montmorency Inc., claimed from appellant the balance owing under a subcontract between it and the bankrupt company.

2 Appellant offered and deposited $6,476.84. It now acknowledges owing a further amount of $2,500. However, it denies owing the further sum of $27,116.28 which it was ordered to pay by a judgment of the Superior Court, affirmed unanimously by the Court of Appeal.

3 Its contestation is based on the fact that since the bankruptcy, in reliance on a clause of the contract, it has already paid this amount directly to Tuyaux Vibrés Inc., a supplier of materials which was a creditor of Maçonnerie

Montmorency Inc.

4 The only point at issue here is whether the contractual clause relied on can be applicable after the bankruptcy of the subcontractor Maçonnerie Montmorency Inc.

5 In an initial contract dated October 31, 1969 with Defence Construction (1951) Ltd., acting on behalf of the Department of National Defence,representing Her Majesty the Queen in right of Canada, appellant undertook the design and construction of vehicle storage and maintenance facili ties at the Canadian Forces Base at Valcartier. Clause 21 of this contract reads:

> 21. (1) Her Majesty may, in order to discharge lawful obligations of and satisfy lawful claims against the Contractor or subcontractor arising out of the execution of the work, pay any amount which is due and payable to the Contractor pursuant to the Terms of Payment or is payable pursuant to section 41 of the General Conditions following a conversion of a negotiation of the security deposit directly to the obligees of and the claimants against the Contractor or the subcontractor.
>
> (2) A payment made pursuant to subsection (1) is to the extent of the payment a discharge of Her Majesty's liability under the contract to the Contractor.
>
> (3) To the extent that the circumstance of the work being executed for Her Majesty permits it, the Contractor will comply with all laws in force in the Province where the work is being executed relating to payment periods, mandatory holdbacks, and creation and enforcement of mechanics' liens or, if such Province is the Province of Quebec, the law relating to privileges.
>
> (4) The Contractor will discharge all lawful obligations of his and will satisfy all lawful claims against him arising out of the execution of the work at least as often as the Terms of Payment require Her Majesty to discharge Her obligations to the Contractor.
>
> (5) The Contractor will, whenever so requested by the Engineer, make a statutory declaration deposing to the existence and condition of the obligations and claims referred to in subsection (4).

6 By a subcontract dated December 23, 1969, appellant delegated the masonry work to Maçonnerie Montmorency Inc. It provided in clause 1:

> [TRANSLATION] The Subcontractor undertakes to provide all materials and perform work as described in Clause IV hereof, relating to the construction of vehicle storage and maintenance facilities for DEFENCE CONSTRUCTION (1951) LTD., hereinafter referred to as "the Owner", Canadian Forces Base, Valcartier, Que., *in accordance with the general terms and conditions of the contract concluded between the Owner and the Contractor*, and pursuant to the plans and specifications to be completed by T. PRINGLE & SON LIMITED (pursuant to bid documents of D.C.L. (1951) Ltd.), hereinafter referred to as the Architect/Engineer. These plans and specifications form an integral part of the contractual documents between the Owner and the Contractor, and are binding on the Subcontractor in so far as they relate to the work referred to in this subcontract, and *the general terms and conditions of the contract concluded between the Contractor and the Owner are binding on the Contractor and the Subcontractor in so far as they relate and are applicable to this subcontract.*
>
> (Emphasis added.)

7 Respondent admitted that as a consequence of this clause, [TRANSLATION] "The general terms and conditions of the contract concluded between the Crown corporation and the general contractor, the appellant in the case at bar, of which clause 21 is a part, applied to the contract concluded between the appellant and the bankrupt, Maçonnerie

Montmorency Inc."

8 However, appellant did not rely directly on this clause as part of its subcontract. Rather, it argued that notwithstanding the bankruptcy, the owner could still rely on Clause 21 and make its payment directly to a subcontractor or a supplier of materials. Its submission is that as a matter of fact it paid Tuyaux Vibrés Inc. rather than the trustee at the insistence of the federal Crown. It said the following:

> [TRANSLATION] ...the owner, THE FEDERAL CROWN, acting through its agent "DEFENCE CONSTRUCTION" (1951) LTD., took the following position:
>
> (a) it wished to protect the subcontractors and suppliers and to ensure that their claims would be paid; in support of its position, it cited Clause 21 of the general contract between the owner and the general contractor;
>
> (b) it further insisted on payment being made in the ordinary course of business, that is, for it to be made directly by Appellant to the supplier: this procedure was justified by the fact that Appellant, as the general contractor, was in a better position than the owner to assess the merits and quantum of the claim by the supplier TUYAUX VIBRES INC.;
>
> (c) the owner further clearly indicated to Appellant that it would pay the supplier TUYAUX VIBRES INC. directly if Appellant neglected to do so, and would deduct the amount so paid to TUYAUX VIBRES INC. from any amount which it might owe Appellant;
>
> Indeed, it appears from the evidence that although the work had been completed and the holdbacks were due to be paid by the owner to Appellant, the owner nonetheless held back approximately $250,000.00, that is the normal holdback of $200,000.00 which was due and payable to Appellant and a further special holdback of $50,000.00, to cover the claim of the supplier TUYAUX VIBRES INC. in the amount of $27,116.28.

9 In its argument appellant placed great reliance on the fact that it did not voluntarily pay TUYAUX Vibrés Inc. rather than the trustee, but because of the pressure placed on it to do so by the owner. I do not for my own part see that this changes the legal position in any way. I would refer in this regard to Montgomery J.A. who, speaking for the Court of Appeal, wrote:

> I do not question the good faith of the administrators of Defence Construction nor of Appellant and I have considerable sympathy for Appellant, which yielded to pressure to make this direct payment to the supplier in order to obtain full payment of the contract price due to it.

10 However, it is necessary to return to the fundamental question of whether such a contractual clause can be applied after the bankruptcy, so that the payment made by appellant to a creditor of the bankrupt company would have the effect of releasing appellant from its obligations to the trustee.

11 Whether appellant paid the supplier of materials Tuyaux Vibrés Inc. instead of the trustee because it was forced to do so by the owner who was relying on Clause 21 of the principal contract between it and appellant, or whether it did so because it relied itself on a similar clause which had become part of its subcontract with the bankrupt company, the question to be decided is still the same: can this clause be put into effect after the bankruptcy so as to authorize a debtor of the bankrupt company to pay a creditor of the latter instead of the trustee, if it chooses to do so?

12 Appellant submitted that the trustee takes the property of the bankrupt subject to the latter's rights and obligations. Appellant cited various passages from Duncan and Honsberger, *Bankruptcy in Canada*, and from *Halsbury's Laws of England* in support of this proposition, which was not disputed by respondent and which in my view is not at

issue.

13 To illustrate the application of the principle, appellant referred to two judgments of Panneton J. of the Superior Court, where the latter held that the provisions of art. 1543 *C.C.*, regarding the right to cancel a sale when payment of the price is not made, apply notwithstanding a bankruptcy, provided that, according to the second paragraph of this article, in the case of a bankruptcy the right can only be exercised within 30 days of delivery (*In re Rosenzweig, Goldfine's Claim* (1920), 1 C.B.R. 385; *In re Prima Skirt Co., Thompson's Claim* (1921), 1 C.B.R. 438). I do not think that these judgments are in any way relevant. The right of cancellation is conferred by the *Civil Code* in all circumstances and its exercise is not inconsistent with the *Bankruptcy Act*, R.S.C. 1970, c. B-3.

14 I also do not regard as relevant the decision of the British Columbia Court of Appeal in *R. v. Hodges* (1921), 1 C.B.R. 530, in which the contract provided that in the event of a default by the contractor, the Crown would take possession of two vessels which the Court found to be subject to a lien in favour of the Crown: in that case the Crown took possession before the bankruptcy.

15 However, the two judgments of English courts to which appellant referred this Court are much more relevant: *In re Wilkinson, ex parte Fowler*, [1905] 2 K.B. 713; *In re Tout & Finch Ld.*, [1954] 1 W.L.R. 178.

16 These two judgments involve situations and contractual clauses which are quite similar to those of the case at bar.

17 In the relevant part of his judgment in *Tout & Finch*, Wynn-Parry J. of the Chancery Division cites lengthy extracts from the *Wilkinson* case on which he relies, but without adding further reasons of his own. I shall therefore deal only with the *Wilkinson* judgment.

18 The headnote of the latter case reads as follows:

> In September, 1903, A. signed a contract with a local authority to construct sewage works at a price to be paid to him by monthly instalments, less 10 per cent., on the certificate of the engineer of the local authority; the 10 per cent. to be retained and paid to A. six months after completion of the works. The contract also provided that certain machinery for the works was to be supplied to A. by specified firms, and that (clause 54), "If the engineer shall have reasonable cause to believe that the contractor is unduly delaying proper payment to the firms supplying the machinery, he shall have power if he thinks fit to order direct payment to them."
>
> On October 12, 1904, A. was adjudicated bankrupt on his own petition. At this date the contract was substantially completed, and there was then due under it the sum of 1574*l.* 15*s.* 10*d.* only, of which 1349*l.* 17*s.* 8*d.* was retention money and 224*l.* 18*s.* 2*d.* was a sum payable on the engineer's next certificate, and these two sums were claimed by the trustee in bankruptcy. At the same date A. owed 836*l.* 8*s.* 9*d.* in various amounts to the specified firms for machinery supplied to him for the works; and subsequently the engineer in 1905 made two orders under clause 54 directing payment of the 836*l.* 8*s.* 9*d.* out of the 1574*l.* 15*s.* 10*d.* to the firms in settlement of their accounts:
>
> > *Held*, that A. by presenting his own petition in bankruptcy "unduly delayed proper payment" to the machinery firms within the meaning of clause 54:
> >
> > > *Held*, also, that the power conferred by that clause on the engineer was not annulled or revoked by A.'s bankruptcy; and that the firms by virtue of the two orders of the engineer were entitled to be paid the 836*l.* 8*s.* 9*d.* out of the 1574*l.* 15*s.* 10*d.* in priority to the claim of the trustee.

19 Bigham J. comments on clause 54 as follows [at pp. 719-20]:

That clause, in my opinion, is inserted in the contract for the benefit, not only of the people who supply the machinery, but also of the council itself. It is very much to the interest of the council to see that contracts of this kind for public works into which they enter are carried out in a manner satisfactory to all persons who are concerned in the performance of them. The council certainly may, and no doubt frequently do, make contracts of this kind, and they make them such more advantageously when the people who supply the machinery or other goods which are to be used by the contractor in the performance of the contract know that there is a reasonable probability that they will be paid. The council are enabled, by inserting a clause of this kind in their contract, to give a certain amount of confidence to people who supply goods to the contractor, and in that way they are placed in a better position when they come to make contracts again than they otherwise would be; and, therefore, I say that the clause is inserted, not only in the interests of the persons who supply goods to the contractor, but also in the interests of the council themselves. Now what is the meaning of the clause? I think it means that, if the persons supplying machinery to the contractor for the purpose of the contract are not promptly and properly paid by him, they can apply to the engineer, and then it shall be competent for the engineer to intervene and, by a proper certificate given in that behalf, to require the council to pay to the machinery firms the amount of their accounts directly — that is to say, not through the hands of the contractor at all, but the money is to be paid directly by the council to the machinery firms. That is the meaning of the clause.

20 As regards the applicability of the clause, the judge goes on to say:

It amounts to an authority given by the contractor — that is to say, by the bankrupt in this case — to the engineer representing the council to dispose of money, which would otherwise come to the bankrupt, in a certain way under certain circumstances. It is an authority which, in my opinion, it was not competent for the bankrupt to withdraw, and it was never contemplated he should withdraw it; and, indeed, it is not contended on behalf of the trustee that the authority was one that could be lawfully withdrawn. It is an authority, therefore, which the bankruptcy of the contractor did not annul.

21 The judge notes that the case concerns an authorization given by the contractor, the bankrupt, to the engineer, representing the Council, to dispose of monies normally due to the bankrupt, in a certain way under certain circumstances. This authorization could not be revoked by the bankrupt and it was never expected that he would be able to revoke it. Accordingly, the judge concluded, the authorization had not been cancelled by the bankruptcy.

22 The judge gave no reasons for his conclusion except to say that the authorization given by the contractor was irrevocable. With respect, I cannot subscribe to that conclusion. In my opinion, the real question is whether, after the bankruptcy, this authorization, revocable or not, still applies so as to supersede the provisions of the *Bankruptcy Act*. I feel that this question must be answered in the negative.

23 In *Industries Saguenay Ltée v. Industries Couture Ltée*, [1973] C.A. 316, the Court of Appeal had to consider clauses 26 and 27 of the "General Terms and Conditions of the Contract" between the Government of Quebec and the general contractor:

[TRANSLATION] Clause 26. Requests for payment. The contractor shall submit to the architect a request in respect of each payment and, if required for a good reason, receipts or supporting documentation indicating the payments made by it for labour and materials, including materials on the site but not yet incorporated in the work, and payments made to subcontractors or in respect of any obligation to which it is subject and which, if not discharged by it, may devolve on the owner.

. . . . .

Clause 27. Certificates and payments. — If the contractor has made a request in the manner explained above, the

architect shall, on the due date of each payment at the latest, issue to the contractor a certificate in accordance with clause III of the agreement, but such a certificate may provide for the holding back of sufficient amounts to protect the owner in respect of any privilege, and may be refused if the architect concludes that the payments owed to subcontractors have not been made.

24 Deschênes J.A., as he then was, made the following general observations in reasons concurred in by Lajoie J.A.:

[TRANSLATION] One cannot stress too strongly the importance of this matter for the construction industry, when it means contributing to the development of the public domain. A principal contractor and subcontractors are in that case deprived of the protection afforded them in the ordinary course of private business by the registration of a privilege on the immovable to which they have contributed. This is what the Supreme Court of Canada, affirming a judgment of this Court, held in *Concrete Column Clamps Limited v. The city of Quebec and la Compagnie de Construction de Québec Limitée*, [1940] S.C.R. 522. This Court restated the same principle in *Stanton Pipes (Canada) Ltd. v. Sylvain* et un *Autre* et la *Corporation municipale de la paroisse de Ste-Anne de la Pointe au Père*, [1966] Que. Q.B. 860.

Doubtless in order to get around this situation, but without departing from the principle which places the public domain beyond the reach of a private privilege, the Crown inserted in its contract with Rivemont the provisions requiring Rivemont, for all practical purposes, to pay its subcontractors and suppliers before it could require payment by the government of the amounts stipulated in the contract.

In the normal course of things, this protection would undoubtedly be sufficient; but what happens when, as here, a subcontractor makes use of the Bankruptcy Act? Does the supplier of materials have any security, or will he be relegated to the position of an ordinary creditor and risk receiving only a part — here 25% — of his debt, which, in private industry, would have benefited from the security subject to his privilege?

Saguenay maintained that its position was that of a secured creditor, and Couture disputed this. That is the question on which the Superior Court ruled against Saguenay.

25 Deschênes J.A. concluded, on the first part of the appellant's argument:

[TRANSLATION] In any case, even if Saguenay is given the benefit of the interpretation of the contract which is most favourable to its interests, there is so far as I know no legal provision — and appellant has referred the Court to none — which has the effect of creating any preferred right in favour of Saguenay against Couture. At most, the contract becomes a means by which Saguenay can pressure Couture to make speedy payment, and which Couture can in its turn use against Rivemont. However, each party's debt is not thereby improved or altered and the right of each creditor against his co-contractor remains a purely personal right.

A fortiori, then, there must be a negative answer to the question whether Saguenay became a secured creditor of Couture. Unquestionably, the contract at issue here never created in Saguenay's favour "a mortgage, hypothec, pledge, charge, lien or privilege on or against the property" of Couture, "as security" for any debt which Couture might owe Saguenay.

It must follow, therefore, that Saguenay does not fall within the first part of the definition of "secured creditor" in the Bankruptcy Act.

26 In *In re John East Co.* (1940), 21 C.B.R. 232, the Ontario Department of Highways in its contract reserved the following power in the event of a default by the general contractor:

> ...it shall be lawful for the department to pay such workmen the amount that may be justly owing to them and the amount of any just accounts for material and for camp and equipment supplies so furnished, or work done or accounts for equipment rented, or accounts for freight incurred and accounts for all other materials and supplies furnished, or work done and charge the same against any moneys due or to grow due to the contractor.

27 Urquhart J. of the Supreme Court of Ontario said, *inter alia* [at p. 235]:

> The clause does not obligate the department to do anything. It just provides that the department may retain from the money certain amounts until satisfactory evidence is furnished that liabilities have been discharged, and secondly if any workman or material man is unpaid that it shall be lawful for the department to pay the same and charge it against the contractor's moneys. There is no obligation on the department either to retain any money or if it does retain any money to pay the same to a contractor. Why this clause is inserted in the contract is difficult to understand. I presume that it is put in *ex abundanti cautela* because there is no privity between the department and the sub-contractors and the department is not under any obligation whatever to them.

He continued [at p. 236]:

> It seems to me that the trustee is the proper person to receive these moneys and administer them. I do not think there is any authority on which I can safely say that there is an equitable assignment of the money in the hands of the Government and the proceeds of the settlement which is conceded by all parties to be a very good settlement.

28 The judge accordingly dismissed the request of several subcontractors and supplier of materials that the monies held by the government be paid to them instead of being handed over to the trustee.

29 In the case at bar, the supplier of materials Tuyaux Vibrés Inc. is a complete stranger to the clause linking the owner and the general contractor, and between the latter and the bankrupt subcontractor.

30 Clause 21 contains only an option which the owner reserved in the principal contract, and appellant in its sub-contract: no obligation has been created.

31 There is no contract of guarantee which presupposes a contractual relationship between appellant and Tuyaux Vibrés Inc. (*Civil Code*, art. 1028).

32 There is no stipulation for the benefit of a third person, which requires that an obligation be undertaken by the promisor, whereas here neither appellant nor Defence Construction (1951) Ltd. has undertaken any obligation (*Civil Code*, art. 1029).

33 There is no novation, which would require the participation of Tuyaux Vibrés Inc.: the latter is a stranger to the contracts between Defence Construction (1951) Ltd. and appellant and between the latter and Maçonnerie Montmorency Inc. (*Civil Code*, arts. 1169 *et seq.*).

34 There is no delegation of payment, which assumes an obligation undertaken by the new debtor (*Civil Code*, art. 1173).

35 Finally, there is no assignment of a debt by Maçonnerie Montmorency Inc. to Tuyaux Vibrés Inc. (*Civil Code*, art. 1570).

36 There is no legal connection between Tuyaux Vibrés Inc. and appellant, nor between Tuyaux Vibrés Inc. and Defence Construction (1951) Ltd. Tuyaux Vibrés Inc. could not enforce any claim against either one or the other.

37 Its only claim is against the bankrupt company, Maçonnerie Montmorency Inc.

38 Its claim is neither preferred nor secured. Appellant indeed is not arguing the contrary.

39 The payment made by appellant to Tuyaux Vibrés Inc. remains a payment made on behalf of the bankrupt company, which as of the date of the bankruptcy can make no further payments (*Bankruptcy Act*, s. 50(5)).

40 From the date of the bankruptcy also, the debt of Maçonnerie Montmorency Inc. against appellant passed into the hands of the trustee as part of the property of the bankrupt company, and only the trustee can obtain payment of it (*Bankruptcy Act*,ss. 47, 50).

41 It would be to disregard the *Bankruptcy Act* and deprive it of all meaning if the debtor of a bankrupt, instead of paying the trustee, were authorized, by contract or some other means, to pay one or other of the creditors of the bankrupt as he saw fit.

42 I adopt the conclusion of Montgomery J.A., speaking for the Court of Appeal:

> The above clause of the general conditions may be perfectly valid and effective where there is no question of bankruptcy. I cannot, however, agree with Appellant that it can supplant the provisions of the Bankruptcy Act and entitle one unsecured creditor to be paid by preference, which would almost necessarily operate to the detriment of the other unsecured creditors. I regard this as contrary to the policy of the Bankruptcy Act.

43 Under s. 112 of the *Bankruptcy Act*, "Subject to this Act, all claims proved in the bankruptcy shall be paid *pari passu*."

44 Tuyaux Vibrés Inc. was not a preferred creditor or a secured creditor, and had no claim to assert against appellant or against Defence Construction (1951) Ltd., which were under no obligation toward it: it therefore had to submit its claim to the trustee and be paid *pari passu* with the other claims proven in the bankruptcy.

45 One might query whether, instead of suing appellant, the trustee could not have claimed from Tuyaux Vibrés Inc. the monies paid to it, or whether appellant can now recover them. The Court is not required to answer these questions in this appeal. As it is, the payment made to Tuyaux Vibrés Inc. by appellant did not release the latter from its obligation to the trustee.

46 For these reasons, I would dismiss the appeal with costs.

Appeal dismissed with costs.

Solicitors of record:

Solicitors for the appellant: *Chait, Salomon, Gelber, Rein, Bronstein, Litvack, Echenberg & Lipper*, Montreal.

Solicitors for the respondent trustee: *Langlois*, Drouin & Associés, Montreal.

END OF DOCUMENT

Tab 2

Court of Queen's Bench of Alberta

Citation: Horizon Earthworks Ltd. (Re), 2011 ABQB 799

Date: 20111220
Docket: BK03 115363
Registry: Edmonton

In the Matter of the Bankruptcy of Horizon Earthworks Ltd. ("Horizon"); and
In the Matter of requests for advice and direction in respect to the Harper Creek Funds.

Memorandum of Decision
on applications seeking advice and direction
in respect to the payment of the Harper Creek Funds
of the
Honourable Mr. Justice D.R.G. Thomas

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A. Background Facts

[1] The background to this dispute is set out in the Trustee's First Report (the "Trustee's First Report") filed with the Court by Deloitte & Touche Inc. (The "Trustee") on November 9, 2011.

[2] The basic facts outlined in the Trustee's First Report were elaborated on in more detail in the Trustee's Brief which has also been filed with the Court. All parties who were present at the time of oral submissions on November 29, 2011 acknowledged that the facts summarised in the Trustee's Brief state fairly the context of this dispute. For ease of reference and with some minor revisions and additions that portion of the Trustee's Brief is set out as a basis for this decision.

[3] Horizon was a company that specialized in road construction, rough grading and base work throughout northern and central Alberta.

[4] On November 13, 2009 Deloitte & Touche Inc. was appointed Interim Receiver and Monitor of the property of Horizon.

[5] On November 20, 2009 the rule of the Interim Receiver was expanded Deloitte & Touche Inc. was appointed as the Receiver of Horizon's property (the "Receiver")

[6] On April 13, 2010 Horizon was assigned into bankruptcy and Deloitte & Touche Inc. was appointed as the Trustee.

[7] At the time that Horizon was placed into receivership, Horizon had several uncompleted contracts in different locations in Alberta.

[8] One of these uncompleted contracts was with the Municipal District of Greenview No. 16 ("Greeniew") under which Horizon agreed in September 2008 to perform road grading and other work on the Harper Creek Road (Range Road 264) (the "Harper Creek Contract"). The total tender price of Horizon's bid was for $1,523,324.00, plus G.S.T.; however, Greenview has since indicated that the estimated total amount to be paid under the Harper Creek Contract is $1,497,824.43, plus G.S.T.

[9] On October 20, 2008, Horizon posted a Performance Bond (the "Performance Bond") and a Labour and Material Payment Bond ("Labour and Material Bond"), each in the amount of $761,662.22 (the Performance Bond and the Labour and Material Bond are collectively referred to as the "Bonds"). Horizon is the principal, Greenview is the obligee, and Western Surety Company ("Western Surety") is the surety under the Bonds.

[10] Prior to the posting of the Bonds, on or about April 28, 2008 Horizon and Western Surety had executed an agreement` in consideration for Western Surety providing bonding to Horizon (the "Indemnity Agreement"). The Indemnity Agreement contains, among others, the following terms: *Indemnification of the Surety* (clause #17), *Assignment of the Principal's rights (clause*

#20), and *Trust funds (clause #22)*. A full copy of the Indemnity Agreement containing these terms is included in the Trustee's Brief under Tab 1.

[11] On or about November 17, 2009 Western Surety sent Greenview a letter indicating that through the Indemnity Agreement Horizon had assigned to Western Surety all funds due to it under the Harper Creek Contract. The Receiver disputed Greenview's ability to make any payments to Western Surety and Greenview continues to hold those funds.

[12] On or about December 17, 2009, Greenview declared Horizon to be in default of the Harper Creek Contract for:

(a) discontinuing the provision of the services;

(b) failing to provide the services with sufficient workers or material to promptly complete the contract; and

(c) failing to promptly pay its creditors for labour, services, equipment and related items.

[13] At the time Greenview declared Horizon to be in default of the Harper Creek Contract, Greenview estimated that there was $774,260.92 unpaid to Horizon under the Harper Creek Contract.

[14] Greenview made a claim under the Performance Bond and Western Surety arranged for Petrowest Construction LP ("PetroWest") to complete the outstanding work under the Harper Creek Contract, pursuant to an agreement between Greenview, Petrowest and Western Surety (the "Completion Contract").

[15] Petrowest completed the outstanding work pursuant to the Completion Contract on or about August 9, 2010.

[16] Greenview had to pay Petrowest the amount of $383,010.65 to complete the work under the Completion Contract due to more favorable rates existing than at the time the Harper Creek Contract was executed.

[17] As such, Greenview estimates that there is a $391,250.27 balance owing under the Harper Creek Contract after setting off amounts paid under the Completion Contract (the "Harper Creek Funds").

[18] Greenview received notices from many subcontractors and suppliers of Horizon that their respective work or materials have not been paid for by Horizon on the Harper Creek Road project (the "Unpaid Third Party Claims"). Greenview advises that the Unpaid Third Party Claims total $922,807.12.

[19] The Trustee understands that several of the employee related Unpaid Third Party Claims have been paid in full, or in part, through the Wage Earner Protection Program. Horizon's former controller has also indicated to the Trustee that several of the claims do not properly reconcile with Horizon's books and records, and as such, may not be due and owing by Horizon pursuant to the Harper Creek Contract. Therefore, there is some uncertainty regarding the actual total of the Unpaid Third Party Claims.

[20] Western Surety advises that some of these same suppliers or subcontractors that form part of the Unpaid Third Party Claims have also made claims against the Labour and Material Bond and commenced actions against Western Surety. Western Surety advises that the total value of such claims is $773,285.15.

[21] At all times during the events described above, Horizon had two primary secured creditors, the Bank of Nova Scotia (the "Bank") and Roynat Inc. ("Roynat"). Both held security over all present and after acquired personal property of Horizon.

[22] The Receiver determined that the security of the Bank had priority over all other contractual secured creditors insofar as inventory, receivables, book debts and other intangibles of Horizon along with the proceeds thereof, and that Roynat's security had priority over all other contractual secured creditors insofar as concerns all other personal property of Horizon, inclusive of proceeds thereof. A copy of the General Security Agreement (the "GSA") executed by Horizon in favour of the Bank and dated May 29, 2008 is found under Tab 2 of the Trustee's Brief.

[23] The secured indebtedness owed to each of the Bank and Roynat by Horizon is materially greater than the amount represented by the Harper Creek Funds.

[24] Roynat, the Bank, and the Receiver entered into an assignment agreement, wherein the Receiver assigned its interest in any and all remaining assets of Horizon to the Bank and Roynat, as the case may be (the "Assignment Agreement"). As part of the Assignment Agreement, the Receiver assigned, among other things, all of its right title and interest in the remaining book debts of Horizon to the Bank in exchange for a credit against the indebtedness owed by Horizon to the Bank (the "Book Debts Assignment"). The Assignment Agreement is found under Tab 3 of the Trustee's Brief.

[25] On June 2, 2011 this Court approved by Order the Assignment Agreement and also discharged the Receiver. In addition, the Receiver was removed as a plaintiff or applicant, as the case may be, in any and all legal proceedings outstanding, with the Bank being substituted in its place if the subject matter of the legal proceeding concerned inventory, receivables, book debts, or other intangible assets of Horizon, or the proceeds thereof. See Appendix A of the Trustee's First Report.

[26] The Trustee has confirmed that there are no funds or other assets in the estate of Horizon in bankruptcy.

[27] With this factual background the parties made a number of applications.

B. Applications Made

[28] The Trustee seeks:

a) advice and direction in respect to which interested party is entitled to the Harper Creek Funds potentially owing to the bankrupt Horizon by Greenview pursuant to the Harper Creek Contract;

b) an order granting the Trustee its fees and disbursements, including legal costs on a solicitor and its own client full indemnity basis, out of the funds currently held by Greenview prior to any other distribution of the funds; and

c) an order removing the Trustee from all legal proceedings relating to the Harper Creek Contract.

[29] Greenview seeks advice and direction as to whether it can pay directly subcontractors and suppliers of the bankrupt Horizon out of the Harper Creek Funds and then deduct such payments from the amounts which it says would be due to Horizon under the Harper Creek Contract.

[30] Western Surety makes a claim to the Harper Creek Funds on behalf of the unpaid subcontractors who have issued claims under the Labour and Material Bond by virtue of the Irrevocable Assignment and Trust Declaration or, alternatively, by virtue of the application of the doctrines of set-off and subrogation.

[31] The Bank makes a cross-application for a declaration that it has a registered security interest and priority to the Harper Creek Funds and seeks a direction that these funds be paid forthwith by Greenview to the Bank.

C. Issues Arising

[32] The issues arising from these applications:

a) The question stated by counsel for the Trustee at the outset of oral submissions as to whether Greenview and Western Surety can rearrange the priority of claims to the Harper Creek Funds through a private arrangement. Put another way, is the proposal for the payment of the Harper Creek Funds to unsecured creditors of Horizon which is made by Greenview and Western Surety compliant with the scheme of the *Bankruptcy and Insolvency Act*, R.S.C. 1985, c. B-3

(the "*BIA*") dealing with the priority of claims in a bankruptcy, specifically ss. 136 and 141 of the *BIA*?

b) Does the registered security interest of the Bank in the property of Horizon attach to the Harper Creek Funds?

c) Do the terms of the Harper Creek Contract allow Greenview the option of directly paying Horizon's unpaid suppliers and subcontractors out of the Harper Creek Funds, and then deducting such amounts from the balance owing to Horizon in these circumstances?

d) Are the Harper Creek Funds subject to an express trust as a result of the Indemnity Agreement?

e) Does the Indemnity Agreement constitute a security arrangement that is subject to the provisions of the *Personal Property Security Act*, R.S.A. 2000, c. P-7, as amended (the "*PPSA*")?

f) Is Western Surety subrogated to the rights of Greenview?

D. Analysis

[33] The resolution of the first issue of whether the proposal of Greenview/Western Surety is compliant with the provisions of the *BIA* is dispositive although I do go on to make an alternative finding in favour of the position of the Bank.

[34] Counsel for the Trustee made a succinct oral submission in respect to the scheme of distribution proposed by Greenview/Western Surety. Firstly, this submission observed that the unpaid subcontractors and suppliers are unsecured creditors of the bankrupt Horizon, not of Greenview. He observed that the circumstances here are covered by ss. 136 and 141 of the *BIA* which sets out the priority regime for secured, preferred and unsecured creditors of a bankrupt. If there is anything to share with the latter group then the unsecured creditors share rateably (s. 141 of the *BIA*). The proposal of Greenview in respect to the group of unsecured creditors is to have them preferred over a secured creditor, in this case the Bank. Counsel for the Trustee has characterized this proposal as a "private reorganization" of the priority regime mandated by the provisions of the *BIA*, particularly ss. 136 and 141. It was observed that no authority has been put forward to support this sort of "private reorganization" of the priority regime nor were any public policy arguments advanced as to why this sort of approach could or should be taken.

[35] Counsel for the Trustee concluded his submission by stating that if parties were allowed to construct their own priority regimes outside of the regimes mandated by the *BIA* that would create a potential for significant mischief.

[36] I agree that the Trustee's analysis is applicable to the proposal put forward by Greenview/Western Surety. However, I will supplement the observations made by the Trustee's counsel by adding some public policy reasons which are to some extent self evident when one looks at the purpose and scheme of the *BIA* as a whole and in respect to the priority scheme of that legislation, in particular.

[37] The *BIA* is meant to provide a high level of certainty and predictability for all manner of creditors. Indeed, significant financing arrangements which involve the granting and registration of security by a debtor are constructed on the premise that the taking of security will reduce the risk of loss in the event a default results in an insolvency. The statutory regime prescribed by the *BIA* provides predictability and certainty in this respect.

[38] Further, the priority regime of the *BIA* enables the timely resolution of claims. Indeed, when one looks at the way the claims were dealt with by the Receiver/Trustee here it appears that Deloitte & Touche Inc. proceeded to assess the various claims and those claims moved along at a reasonable pace thereby ensuring that the claims were dealt with in accordance with the priority scheme contemplated by the *BIA*. All claims identified and assessed by the Receiver/Trustee were disposed of and the Receiver was discharged by an order of this Court. To allow the proposal of Greenview/Western Surety would extend the proceedings and would defeat the intention of the *BIA* that all claims be assessed and brought to conclusion in a timely way.

[39] The clear intent of the *BIA* is to provide for certainty in the resolution of claims. It exists to prevent this sort of private arrangement which would lead to the reordering of priorities by agreement between interested parties. Also, this late claim and applications have created a cost burden for the Trustee in that the Court has sought the assistance of the Trustee in responding to these multiple requests for advice and direction and the cross-application by the Bank.

[40] In summary, the *BIA* provides a scheme to create certainty in respect to competing claims and to bring the administration of the affairs of a bankrupt to a timely and predictable conclusion. This sort of end-run around the legislation which is proposed here should not be and will not be allowed by this Court.

[41] Turning now to the other set of issues and arguments I had said at the outset of oral submissions that I saw this dispute as having two alternative pathways to resolution. Firstly, I noted the statutory pathway urged by counsel for the Bank which involves the analysis and application of the provisions of the *PPSA* to resolve these claims. The alternative approach was the application and submissions by Greenview and Western Surety which I characterized as a contractual pathway which would lead to the Harper Creek Funds being paid out directly by Greenview to some of the unpaid sub-trades and suppliers of the bankrupt Horizon.

[42] I have accepted the position put forward by the counsel for the Trustee. However, in the event I am wrong in respect to that very high level approach to the resolution of this dispute than I adopt the approach taken by the Bank in the discussion which follows.

[43] As I have found above the Bank had entered into the GSA with Horizon on May 29, 2008. That GSA granted to the Bank a security interest in all of its present and after acquired property including accounts receivable. The Bank registered its security interest arising from the GSA by way of a financing statement and that registration under the *PPSA* was effected on June 3, 2008 (see the *PPSA* search results under Tab 4 of the Trustee's Brief).

[44] In September 2008, Horizon entered into the Harper Creek Contract with Greenview. That had the effect of creating an account which was subject to the registered security interest of the Bank. The remnant of that account is now reflected in the Harper Creek Funds.

[45] I agree that all of the requirements of s. 12 of the *PPSA* were met by the Bank through its compliance with the registration requirements provided for in that Alberta legislation. That registered security interest attached to what would become the Harper Creek Funds as soon as the Harper Creek Contract was formed in September 2008.

[46] The unsecured creditors of Horizon have not registered any security interests under the *PPSA* and as unsecured creditors cannot take priority to the registered security interest of the Bank. Western Surety has not registered any of its interests under the *PPSA* scheme either.

[47] In the result compliance by the Bank with the statutory scheme set out in the *PPSA* through registration of a security interest trumps the contractual claim of Greenview/Western Surety and their contractually based claim to the Harper Creek Funds is rejected.

E. Summary

[48] In summary:

a) Greenview's application supported by Western Surety is dismissed;

b) The Bank's cross-application for a declaration that it has a security interest in priority to the Harper Creek Funds is allowed and those monies shall be paid forthwith by Greenview to the Bank.

F. Costs

[49] The Bank opposes the payment of the costs of the Trustee out of the Harper Creek Funds. In the event the parties are not able to resolve the costs issue between themselves then all outstanding cost matters shall be dealt with in writing. I will provide further direction in respect to the resolution of costs and I await communication from counsel in that regard.

[50] Once the costs issue is resolved the Trustee shall be removed from all legal proceedings relating to the Harper Creek Contract.

Heard on the 29th day of November, 2011.
Dated at the City of Edmonton, Alberta this 20th day of December, 2011.

D.R.G. Thomas
J.C.Q.B.A.

Appearances:

Ray C. Rutman
Fraser Milner Casgrain LLP
for the Deloitte & Touche Inc.
Trustee in the bankruptcy of the
Estate of Horizon Earthworks Ltd.

Darren R. Bieganek
Duncan & Craig LLP
for the Bank of Nova Scotia

Tim Mavko
Reynolds, Mirth, Richards & Farmer LLP
for the Municipal District of Greenview No. 16

Eleanor A. Olszewski, Q.C.
Dana Nowak
MacPherson Leslie & Tyerman LLP
for Western Surety

Tab 3

1989 CarswellSask 48, 76 C.B.R. (N.S.) 241, 35 C.L.R. 126, 62 D.L.R. (4th) 243, 78 Sask. R. 87

1989 CarswellSask 48, 76 C.B.R. (N.S.) 241, 35 C.L.R. 126, 62 D.L.R. (4th) 243, 78 Sask. R. 87

Canadian Commercial Bank v. Simmons Drilling Ltd.

CANADIAN COMMERCIAL BANK v. SIMMONS DRILLING LTD.

Saskatchewan Court of Appeal

Vancise and Sherstobitoff JJ.A. and Osborn J. (ad hoc)

Heard: June 5, 1989
Judgment: September 14, 1989
Docket: No. 115

Counsel: *L. Andrychuk*, for appellant.

J. Ehmann, for Deloitte, Haskins and Sells.

T. Stodalka, for Oil Patch.

M. Sawatsky, for Shell Products.

Subject: Corporate and Commercial; Insolvency; Contracts

Construction Law --- Construction and builders' liens — Holdback — When payable.

Construction Law --- Construction and builders' liens — Holdback.

Construction Law --- Construction and builders' liens — Trust fund — Distribution of fund.

Secured creditors — Mechanics' liens — Receiver-manager appointed by court at instance of debenture holder — Receiver-manager having funds remaining after payment of subcontractors with registered liens out of receivables from contracts — Receiver-manager failing to discover unpaid subcontractors without registered liens until expiration of one-year limitation period for claims against lien trust fund — Receiver-manager actions constituting default of positive obligations under Business Corporations Act and Builders' Lien Act, and of responsibility to court — Receiver-manager and debenture holder not to benefit from default — Court directing payment of unpaid subcontractors out of funds received on account of contracts.

The plaintiff held a debenture secured by the assets of the defendant. In March 1987, at the instance of the plaintiff, the court appointed a receiver-manager of the defendant under the provisions of the Saskatchewan Business Corporations Act. The order permitted distribution of moneys held by the receiver only by direction of the court. By 31st March 1987 the defendant had completed various drilling contracts. The receiver-manager paid those subcontractors with

registered builders' liens from the moneys received under the contracts and had funds remaining in hand. Upon completion of a review of the defendant's records in March 1988, the receiver-manager discovered that certain subcontractors who had not registered liens were unpaid. In June 1988 the receiver-manager applied for directions as to its obligation to pay these subcontractors in light of the expiration of the one-year limitation period for claims against the lien trust fund under s. 19 of the Builders' Lien Act. The judge declined to answer the question before him but found that the subcontractors had valid unregistered liens, enforceable against the funds received by the receiver-manager. The plaintiff appealed.

Held:

Appeal dismissed.

The trial judgment could not stand because under ss. 70 and 71 of the Act, the bank, holding security that arose prior to the lien, had priority in any event over the unregistered liens.

Pursuant to s. 7 of the Builders' Lien Act, when the receiver-manager was appointed, all of the receivables which eventually were converted into cash came into his possession and under his control impressed with the trust. As the defendant was prohibited from dealing with the receivables by s. 91 of the Business Corporations Act, the receiver-manager was de facto trustee of the trust fund. In addition, the receiver-manager was responsible to the court under s. 92 of the Business Corporation Act and the terms of the order appointing it for the receivables and moneys paid on that account. Section 89 of the Business Corporations Act, together with s. 7 of the Builders' Lien Act, imposed a positive obligation upon the receiver-manager to pay the subcontractors from the trust fund within a reasonable time. The receiver-manager's failure to act with sufficient promptness and diligence to discover and pay the claims against the trust before expiration of the limitation period was in default of those statutory obligations. The receiver-manager's actions were the actions of the court and the court will not permit or approve any action on the part of its officer which has the effect of changing the rights of competing creditors, whether deliberately or by default. The receiver-manager, and through it the plaintiff, must bear responsibility for the consequences of the unpaid subcontractors being deprived of the right to realize their claims from the trust fund. Accordingly, the receiver-manager should pay the claims of the subcontractors from the funds received on account of the appropriate contracts.

Cases considered:

Cornish, Re; Ex parte Bd. of Trade, [1896] 1 Q.B. 99 (C.A.) — *distinguished*

Gen. Rolling Stock Co., Re (1872), 7 Ch. 646 — *distinguished*

Harrisson v. Duignan (1842), 2 Dr. & War. 295 — *distinguished*

Parsons v. Sovereign Bank of Can., [1913] A.C. 160 (P.C.) — *considered*

Plisson v. Duncan (1905), 36 S.C.R. 647 [N.W.T.] — *referred to*

Wrixon v. Vize (1842), 3 Dr. & War. 104 — *distinguished*

Statutes considered:

Builders' Lien Act, S.S. 1984-85-86, c. B-7.1

s. 7

s. 15

s. 16

s. 19

s. 27

s. 33

s. 34

s. 40 [am. 1986, c. 8, s. 3]

s. 49(5)

s. 70

s. 71

Business Corporations Act, R.S.S. 1978, c. B-10

s. 89

s. 91

s. 92

s. 95(d)

Authorities considered:

Bennett on Receiverships (1985), pp. 15-16.39 Hals. (4th), para. 877.Kerr on Receivers, 15th ed. (1978), pp. 130, 142, 159.

Appeal from order of Geatros J., 73 C.B.R. (N.S.) 73, 33 C.L.R. 238, 73 Sask. R. 140, enforcing payment of unregistered liens from funds held by receiver-manager.

The judgment of the court was delivered by *Sherstobitoff J.A.*:

1 The determinative issue in this appeal [from 73 C.B.R. (N.S.) 73, 33 C.L.R. 238, 73 Sask. R. 140] is whether a court-appointed receiver-manager, and the secured creditor at whose instance the receiver-manager was appointed, are entitled to rely upon the time limitation in s. 19(1) of the Builders' Lien Act, S.S. 1984-85-86, c. B-7.1, to obtain priority for the secured creditor over a debt to a stranger to the action, secured by a statutory trust fund, when the time limitation did not elapse until after the appointment of the receiver-manager.

2 These are the relevant provisions of the Builders' Lien Act:

7(1) All amounts:

(*a*) owing to a contractor, whether or not due or payable; or

(*b*) received by a contractor;

on account of the contract price of an improvement constitute a trust fund for the benefit of:

(*c*) subcontractors who have subcontracted with the contractor and other persons who have provided materials or services to the contractor for the purpose of performing a contract; and

(*d*) labourers who have been employed by the contractor for the purpose of performing the contract.

(2) The contractor is the trustee of the trust fund created by subsection (1) and he shall not appropriate or convert any part of the trust fund to his own use or to any use inconsistent with the trust until all persons for whose benefit the trust is constituted are paid all amounts related to the improvement owed to them by the contractor ...

15 In addition to any other priority which a beneficiary of a trust constituted by this Part may have at law, a beneficiary has priority over all general or special assignments, security interests, judgments, attachments, garnishments and receiving orders, whenever received, granted, issued or made, of or in respect of the contract or subcontract price or any portion of the contract or subcontract price ...

19(1) On the expiry of one year after the contract is completed or abandoned:

(*a*) a person who is a trustee under this Part is discharged from his obligations as trustee; and

(*b*) no action to enforce the trust may be commenced.

(2) Subsection (1) does not affect the ability to commence and maintain a prosecution.

3 In 1980 the appellant Canadian Commercial Bank obtained a debenture, including a fixed and floating charge, over the present and future assets of Simmons Drilling Limited. Validity of the debenture and default thereunder were not disputed.

4 Deloitte, Haskins & Sells Ltd. was appointed receiver-manager of the business and property of Simmons at the instance of the bank by the Court of Queen's Bench of Alberta on 20th February 1987 and by the Court of Queen's Bench of Saskatchewan on 3rd March 1987. The orders contain no unusual provisions. They prohibit any action against Simmons or the receiver without the leave of the court. They also permit distribution of any moneys in the hands of the receiver, after payment of expenses, only by the direction of the court.

5 Simmons had drilling contracts with several oil and gas operators in Saskatchewan and had completed various wells between 5th December 1986 and 31st March 1987. The receiver, between 15th May 1987 and 5th February 1988, received moneys due under the contracts and paid therefrom those subcontractors who had registered builders' liens. There remained, in the receiver's hands, about $141,000. During a review of Simmons' records by the receiver conducted between December 1987 and March 1988, it was discovered that there were some subcontractors, including the respondents Oil Patch Group Ltd., J-& L Supply Co. Ltd. and Shell Canada Products Limited, who had supplied services and materials in connection with the drilling of the wells, who were unpaid, and had not registered liens. The receiver applied, on 30th June 1988, to the Queen's Bench for the following relief:

> ... advice and directions as to its obligation, if any, with respect to the possible claims of certain subcontractors of SDL in relation to the proceeds of certain drilling contracts received by the receiver, in light of the provisions of s. 19 of *The Builders' Lien Act*, S.S. 1984-85, c. B-7.1, which proceeds are claimed by the plaintiff Canadian Commercial Bank ("CCB") pursuant to its security interests.

6 Geatros J. declined to answer the question put to him, but found, by application of ss. 27, 33, 34, 40 and 49(5) of the Act, that the respondents had valid unregistered liens, enforceable against the funds received by the receiver under the contracts which constituted holdbacks required by the Act. His judgment cannot stand because, even if the liens were valid (and we pass no judgment on that issue), he misconstrued ss. 70 and 71 of the Act, which gave priority to a secured creditor over a lienholder where the security was given before the lien arose. Thus, the bank had priority in any event over the unregistered liens. We are therefore left to determine the original question which was unanswered below.

7 The issue to be decided is the effect of s. 19 of the Act on priority between the bank as secured creditor and the respondents as beneficiaries of the trust created by s. 7 and given priority by s. 15. That raises the following questions. At what date are priorities determined: the date of appointment of the receiver, the date of receipt of the moneys, the date of application to the court, or the date of distribution? Is a court-appointed receiver entitled to affect priorities between competing creditors by permitting limitation periods to expire even if done inadvertently? Even assuming that s. 19 does not apply to prevent any claim against the trust fund, what moneys are affected: all moneys received on account of the contracts, or only moneys actually received within a year of completion of the contracts?

8 As to the last question, s. 7 makes all amounts owing to a contractor under a contract, whether due and payable or not, a part of the trust fund. Thus, when the receiver was appointed, all of the receivables which eventually were converted into cash came into his possession and under his control impressed with the trust. The date of actual receipt of moneys is therefore irrelevant since the payment simply converted the assets in the trust from receivables to cash to the extent of the payments. There were, at all relevant times, assets in some form in the trust fund sufficient to meet the claims of the respondents.

9 The first two questions must be answered together.

10 The respondents argued that time did not run against them under s. 19 from the date of appointment of the receiver. They relied principally on two cases. *Re Cornish; Ex parte Bd. of Trade*, [1896] 1 Q.B. 99 (C.A.), was a case concerning the application of s. 8 of the Trustee Act, 1888, to a trustee in bankruptcy.

11 The court said at p. 104:

> The other point taken was that s. 8 of the Trustee Act, 1888, applies to the case. In my opinion s. 8, which limits the time for making claims upon trustees, has nothing to do with an officer of the Court who is required by the Court to account. If it had, it would equally apply to a receiver and to other officers of the Court who have been put by the Court in possession of property, and are required to account to the Court. I have never yet heard it suggested that s. 8 of the Trustee Act applied to such cases as that. Moreover, if it did apply, it would not apply to the present case, because if upon taking the account it should appear that the trustee has money in his hands which he has not properly applied, he would come within the exception in s. 8 of the Act, and the limitation of the liability of a trustee would not apply to him at all.

12 In *Re Gen. Rolling Stock Co.* (1872), 7 Ch. 646, the court said this concerning a compulsory winding-up order [pp. 649-50]:

> That being so, I think we must consider that the Legislature intended us to follow the analogy of other cases where the assets of a debtor are to be divided amongst his creditors, whether in bankruptcy or insolvency, or under a trust

> for creditors, or under a decree of the Court of Chancery, in an administration suit. In these cases the rule is that everybody who had a subsisting claim at the time of the adjudication, the insolvency, the creation of the trust for creditors, or the administration decree, as the case may be, is entitled to participate in the assets, and that the *Statute of Limitations* does not run against this claim, but, as long as assets remain unadministered he is at liberty to come in and prove his claim, not disturbing any former dividend.

13 These cases do not apply. They dealt with fact situations and with statutes unrelated to those before us. While *Cornish* mentioned receivers, the reference was obiter dictum. *Rolling Stock*, and the cases upon which it relied, as well as those which followed it, did not deal with receivers.

14 The appellant relied on the common law with respect to receivers and reasoned as follows. A receiver appointed by the court becomes a principal and is answerable to the court which appointed him. As a principal, he is not the agent of the security holder, the debtor or of any particular creditor. He has a duty to exercise such reasonable care, supervision and control of the debtor's property as an ordinary man would give to his own and if he fails to provide this standard of care he may be liable for his negligence: Bennett on Receiverships (1985), pp. 15-16; *Plisson v. Duncan* (1905), 36 S.C.R. 647 [N.W.T.]. The powers and duties of a court-appointed receiver are summarized in *Parsons v. Sovereign Bank of Can.*, [1913] A.C. 160 at 167 (P.C.), by Viscount Haldane:

> A receiver and manager appointed ... is the agent neither of the debenture-holders whose credit he cannot pledge, nor of the company, which cannot control him. He is an officer of the Court put in to discharge certain duties prescribed by the order appointing him; duties which in the present case extended to the continuation and management of the business. The company remains in existence, but it has lost its title to control its assets and affairs ...

15 Unlike a trustee in bankruptcy, a receiver does not become vested with title to the debtor's property. He only has possession and custody of them. As stated in Kerr on Receivers, 15th ed. (1978), at p. 130:

> The appointment of a receiver does not in any way affect the right to the property over which he is appointed. The court takes possession by its receiver, and his possession is that of all parties to the action according to their titles ... [*Re Butler* (1863) 13 L.R. Ir. 456; *Bertrand v. Davies* (1862) 31 Beav. 436.]

The appellant argued that the key portion of this passage was the statement that the possession of the court was the possession only of the parties to the action, and not the possession of all persons who might be interested in the property of the debtor. He cited two cases in support of that proposition: *Harrisson v. Duignan* (1842), 2 Dr. & War. 295, and *Wrixon v. Vize* (1842), 3 Dr. & War. 104. Both cases dealt with receivers appointed by the court to protect the interest of minors in land. The first case held that the appointment of a receiver did not affect the operation of a Statute of Limitations against a stranger to the action. The second case held that the appointment of a receiver did prevent a Statute of Limitations from operating in favour of a stranger to the action. The appellant concluded, relying as well on the interpretation of the same cases in Kerr at pp. 142 and 159, and 39 Halsbury's Laws of England, 4th ed., para. 877, that the application of limitation periods to the recovery of property or the enforcement of encumbrances against an estate in receivership depended entirely upon who was a party to the action. If the person claiming a paramount right was a party to the action, the possession of the receiver was his possession and therefore the appointment of the receiver would prevent the running of the limitation period. If he was a stranger to the action and was out of possession, time would continue to run against him as the possession of the receiver was not his possession. Thus the appellant said, in this case, the respondents being strangers to the action, time ran against them under s. 19, the trust terminated, and the bank had priority.

16 While the foregoing is, in our opinion, an accurate statement of the common law as it existed at the dates of the cases decided, we do not agree that the venerable cases cited by the appellant apply to this case. They were concerned with use of receiverships to protect the property of minors, a procedure long since fallen into desuetude, and were

concerned with adverse possessory claims to land where actual possession was always a crucial factor in determining whether and when limitation periods ran. Furthermore, we are dealing in this case with receivables and cash where actual possession has no bearing on right to claims of entitlement to it. Most importantly, Saskatchewan legislation now governs the appointment and delineates some of the duties of the receiver, and in this case, the receiver has additional obligations superimposed by the Builders' Lien Act.

17 The receiver was appointed under the provisions of the Business Corporations Act, R.S.S. 1978, c. B-10. The relevant provisions of the Act are as follows:

> 89. A receiver of any property of a corporation may, subject to the rights of secured creditors, receive the income from the property and pay the liabilities connected with the property and realize the security interest of those on behalf of whom he is appointed, but, except to the extent permitted by a court, he may not carry on the business of the corporation.
>
> 91. If a receiver-manager is appointed by a court or under an instrument, the powers of the directors of the corporation that the receiver-manager is authorized to exercise may not be exercised by the directors until the receiver-manager is discharged.
>
> 92. A receiver or receiver-manager appointed by a court shall act in accordance with the directions of the court.
>
> 95. Upon an application by a receiver or receiver-manager, whether appointed by a court or under an instrument, or upon an application by any interested person, a court may make any order it thinks fit including, without limiting the generality of the foregoing:
>
> (*d*) an order requiring the receiver or receiver-manager, or a person by or on behalf of whom he is appointed, to make good any default in connection with the receiver's or receiver-manager's custody or management of the property and business of the corporation, or to relieve any such person from any default on such terms as the court thinks fit, and to confirm any act of the receiver or receiver-manager.

18 Thus the receiver held the receivables and moneys paid on account thereof in two representative capacities — as receiver-manager responsible to the court (s. 92 of the Business Corporations Act, and the terms of the order appointing the receiver) and as trustee under s. 7 of the Builders' Lien Act. We reject the argument of the bank that the latter statute made Simmons only the trustee, and that the appointment of the receiver, which gave only the right to possession and not ownership of the receivables, could not substitute the receiver as trustee in the place of Simmons. The receiver received the receivables impressed with the trust. Section 16 of the Builders' Lien Act made anyone who had effective control of a corporation or its relevant activities liable for any breach of trust by the corporation, if assented to or acquiesced in. Simmons was prohibited from dealing with the receivables by s. 91 of the Business Corporations Act. Thus, the receiver became the de facto trustee.

19 The intent of the Builders Lien Act was that the trust fund be used to pay unpaid subcontractors. That did not happen because the directors of Simmons could not do so by reason of s. 91 of the Business Corporations Act and the receiver, for unexplained reasons, did not discover the existence of the unpaid subcontractors until after the time limitation in s. 19 had expired.

20 The material before us discloses that nine or ten months elapsed between the date of appointment of the receiver and the commencement of the review of accounts that disclosed the trust claims of the subcontractors. Another two or three months elapsed before the review was completed, and another three months elapsed before the receiver applied to the court for directions with respect to the claims. No explanation was given for the delays, nor was there any suggestion or evidence of any improper motive on the part of the receiver, and in particular, no suggestion that the receiver deliberately sought to affect priorities between the subcontractors and the bank. Nevertheless, the failure to

discover the claims and to apply to the court for directions until about 16 months after the date of the appointment must be considered a breach of the receiver's obligation to the court to act with diligence and within a reasonable time. The receiver, and through it the bank, must bear responsibility for the consequences of the failure to act with sufficient diligence to discover the claims within a reasonable time, thereby permitting lapse of the limitation period.

21 What is clear is that, when the receiver was appointed, the subcontractors were entitled to payment from the trust fund. The failure to make payment to the subcontractors within a reasonable time thereafter, an obligation imposed by s. 89 of the Business Corporations Act and s. 7 of the Builders' Lien Act taken together, was in default of those statutory obligations. If the receiver had applied to the court for directions for payment out of the moneys on that date or within a reasonable time thereafter, the money would have been ordered paid to the subcontractors. The result is that the default of the receiver in failing to act with sufficient promptness and diligence to discover and pay the claims against the trust before expiration of the limitation period has deprived the subcontractors of the right to realize their claims from the trust fund.

22 The bank now seeks to benefit from that default and the receiver supports its position. That position is untenable. While it may not be improper for a private debtor to withhold payment of a debt due and owing, whether deliberately or by neglect or oversight, and thereby benefit from an intervening limitation period, the same is not true of a receiver, for he is an officer of the court. The receiver's action is the action of the court and the court will not permit or approve any action on the part of its officer which has the effect of changing the rights of competing creditors, whether deliberately or by default.

23 The receiver and the bank argued that the onus was on the subcontractors to assert their claims, rather than on the receiver to discover and pay them. That might be so in other claims against a receiver or the person at whose instance he was appointed. However, in this case, as noted above, we view s. 89 of the Business Corporations Act and s. 7 of the Builders' Lien Act, taken together, as imposing a positive obligation on the receiver to pay the subcontractors from the trust fund within a reasonable time.

24 The court has the power to direct payment to the subcontractors by virtue of s. 92 of the Business Corporations Act and by virtue of the terms of the order appointing the receiver, both of which make distribution by the receiver subject to the direction of the court. The bank, at whose instance the order was obtained, is bound by those provisions.

25 If there is any doubt about the right of the court to act under s. 92 or the order, we would invoke the provisions of s. 95(*d*) of the Business Corporations Act, which permits the court to require the receiver and the bank to make good any default in respect of the receivership. The failure of the receiver to discover and pay the claims of the subcontractors within a reasonable time is such a default and is deserving of remedy by requiring payment by the receiver to the subcontractors from the moneys which would have constituted the trust fund created by the Builders' Lien Act.

26 The court did not consider whether the receiver was in a fiduciary relationship to all interested persons, whether parties to the action or not, either at common law, or by reason of the relevant provisions of the Business Corporations Act, or the Builders' Lien Act, and if so, the effect of that relationship. That question is left open. However, reference must be made to the position of the receiver on an application such as this. The receiver, in its factum, strongly supported the position of the bank. At the opening of the hearing of the appeal, counsel for the receiver was asked why, since the receiver was not the agent of the bank, but an officer of the court, it was taking a position favouring one party against the other. Counsel indicated that he would take no position in argument. Nevertheless, he spoke, when the time came, in favour of the position of the bank. The court took exception to this for two reasons. First, it gave the appearance that the receiver felt itself to be agent of the bank and acted accordingly, which would not be a proper position for an officer of the court. Secondly, since the receiver's failure to act promptly gave rise to the bank's claim to priority, the position taken again gave the appearance of favouring its own interest and that of the bank against another party. We do not suggest any improper motives or lack of good faith on the part of either the receiver or counsel, but take the opportunity to re-emphasize that a court-appointed receiver is not an agent of the secured creditor or anyone else, but is an officer of the court. He must act accordingly.

27 The appeal must therefore fail. The order below is now inappropriate. The application was for advice and directions. It is declared that the receiver shall pay the claims of the respondent subcontractors from the funds received on account of the appropriate contract or contracts. The respondents will have their costs under double col. V.

Appeal dismissed.

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Tab 4

Indexed as:

Donald Developments Limited v. Nova Scotia Power Corp.

Between
Donald Developments Limited, Twin City Rebar Services Limited, Hefler Lumber Company Limited, Chartrite Developments Inc., carrying on business under the firm name and style of Mobile Concrete Services, Provincial Electric (1969) Limited, and Touche Ross Limited, a body corporate, as Trustee pursuant to the provisions of the Bankruptcy Act of the Estate of Standard Construction Company Limited, Plaintiffs, and
Nova Scotia Power Corporation, Defendant

[1988] N.S.J. No. 233

88 N.S.R. (2d) 236

29 C.L.R. 218

10 A.C.W.S. (3d) 258

Action S.H. No. 58032, S.H. No. 58033, S.H. No. 58433,

S.H. No. 58434, S.H. No. 60341, S.H. No. 62245

Nova Scotia Supreme Court - Trial Division
Halifax, Nova Scotia (In Chambers)

Glube C.J.T.D.

Heard: May 18, 1988
Judgment: June 6, 1988

Mechanics' liens -- Holdbacks -- General contractor engaging subcontractors -- General contractor going bankrupt -- Subcontractors claiming entitlement to holdback moneys retained by defendant -- Subcontractors having no contractual rights to compel defendant to pay funds to them -- Order made declaring holdback funds to be paid to trustee in bankruptcy -- Bankruptcy Act, R.S.C. 1970, c. B-3, s. 50(5).

This was an action for a determination of the entitlement to holdback moneys. The argument was between the subcontractors and the trustee in bankruptcy. In 1985, the defendant, Nova Scotia Power Corp., engaged Standard to act as general contractor in connection with the construction of two power substations. Standard, in turn, engaged the plaintiffs as subcontractors. Standard went bankrupt. The plaintiff subcontractors claimed to be entitled to certain money held back by the defendant from progress payments made to Standard. The trustee in bankruptcy of Standard also claimed to be entitled to the money held back by the defendant on behalf of the creditors of Standard.

HELD: The funds presently being held by the defendant were to be paid to the trustee in bankruptcy with prejudgment interest. There was no contractual relationship between the defendant and the plaintiff subcontractors. As of the date of bankruptcy, the entitlement to the holdback funds passed into the hands of the trustee in bankruptcy as part of the property of the bankrupt company and only the trustee could receive the funds.

W. Wylie Spicer and Scott C. Norton, for the Plaintiffs, Donald Developments Limited, Twin City Rebar Services Limited, Hefler Lumber Company Limited, Chartrite Developments Inc., Provincial Electric (1969) Limited.
John MacL. Rogers, for the Plaintiff, Touche Ross Limited.
Peter W. Gurnham, for the Defendant.

GLUBE C.J.T.D.:-- This matter was set down for trial on May 18th and 19th, 1988. On May 16th, 1988, the court was advised that the defendant, the Nova Scotia Power Corporation, and the various subcontractors, namely, Donald Developments Limited, Twin City Rebar Services Limited, Hefler Lumber Company Limited, Chartrite Developments Inc. and Provincial Electric (1969) Limited had settled their claims, which had been based on negligence, negligent representation, and or breach of contract.

The only issue to come before the court was the entitlement of holdback monies totalling $73,084.72. The argument was between the subcontractors and the Trustee in Bankruptcy. Counsel advised agreement had been reached with the defendant as to the rate and period of pre-judgment interest. The defendant dropped its claim for set-off or indemnity from the Trustee.

The parties prepared an Agreed Statement of Facts which read as follows:

> "1. In 1985, the Defendant, Nova Scotia Power Corporation, engaged Standard Construction Company Limited to act as General Contractor in connection with the construction of two power substations. (The conditions of the contract are attached hereto.) Standard, in turn, engaged the Plaintiffs, Donald Developments Limited, Chartrite Developments Limited, Twin City Rebar Services Limited, Hefler Lumber Company Limited and Provincial Electric (1969) Limited, as subcontractors in connection with the project. The Plaintiff, Touche Ross Limited is the Trustee in Bankruptcy of the estate of Standard Construction Company Limited.

2. The Plaintiff subcontractors claim to be entitled to certain monies held back by the Nova Scotia Power Corporation from progress payments made to Standard. The Plaintiff Trustee also claims to be entitled to the monies held back by Nova Scotia Power Corporation on behalf of the creditors of Standard.
3. The contracts between NSPC and Standard with respect to the two jobs are, in all material respects, identical. Under clause 22 of these fixed-price contracts, NSPC was to make monthly progress payments on account of the contract price to Standard against progress estimates of the value of the completed portions of the work done each month. NSPC was to retain 10% of the value of each such payment for a minimum period of 45 days after completion of the contract, and was in any event not to pay the amount of these holdbacks to Standard until the contract was satisfactorily completed and until Standard settled all costs and claims by third parties with respect to the operations of Standard, any subcontractor, their employees and/or agents. Clause 24 of the contracts provided that NSPC, before making progress or final payments, could require Standard to furnish evidence that there were no lawful claims by third parties in connection with the work.
4. Standard's contract was terminated by NSPC in December, 1985, and the remaining work under the contracts was satisfactorily completed by the NSPC.
5. The Power Corporation made its last Progress Payment on the Brushy Hill job when it paid Standard $54,595.93 on November 6, 1985. The Defendant now holds $54,782.16 on the Brushy Hill project and $18,302.66 on the Porter's Lake project.
6. The outstanding claims of the subcontractors without interest are as follows:

Mobile Concrete	$ 49,160.54
Donald Developments	43,508.78
Provincial Electric	31,031.01
Hefler Lumber	3,560.50
Twin City Rebar	34,365.95
TOTAL	$161,626.78

7. NSPC does not dispute that it holds the 10% holdbacks and progress payments totalling $73,084,82. NSPC recognizes that these funds are payable for the work performed with respect to the Brushy Hill and Porter's Lake contract jobs. NSPC views its role with respect to these funds as that of a stakeholder. That is, NSPC is willing to release these funds to whichever of the Trustee or the Subcontractors is found by This Honourable Court to be entitled to them." (The Conditions of Contract referred to in paragraph 1 are not attached.)

At the hearing before the court, counsel for the subcontractors advised that paragraph 4 of the Agreed Statement of Facts is altered to read:

> "By agreement Standard did not complete the work required by the contract, leaving the job in December 1985 and the remaining work (comprised of extras only) under the contracts was satisfactorily completed by the NSPC".

All counsel agreed to this amendment.

As part of the record, the court had before it a document booklet which included the conditions of contract.

At the conclusion of the argument by counsel, the court asked counsel to respond on two matters relating to mechanics' liens. The lands of NSPC are not subject to liens as the company is categorized as an agent of the Crown. Apparently, mechanics liens were filed, but at the time, all parties agreed that these liens could not stand. Both parties submitted opinions to the court and I am satisfied that the questions I asked in no way affect the determination to be made.

On behalf of the subcontractors, it is acknowledged that they have two major hurdles to overcome in the form of two decisions: Re Union Construction et al 1980 42 N.S.R. (2nd) and 77 A.P.R. 622 (N.S.S.C. Appeal Division) and A.N. Bail Co. Ltee. v. Gingras et al, [1982] 2 S.C.R. 475.

The trial decision of Re Union is found at page 551 of 41 N.S.R. (2nd) and 76 A.P.R. It sets out the facts in detail. It must be noted that this case also involved the Nova Scotia Power Corporation. Briefly, the facts are that on May 12, 1977, the Nova Scotia Power Corporation entered into a general contract for the construction of a facility at Lingan with Lundrigans Limited. Lundrigans awarded a subcontract to Union Construction Limited for performance of a portion of the work. Union Construction Limited entered into various subcontracts with a number of parties who supplied services and/or materials to the project. The project was completed and a substantial sum remained due to Lundrigans relative to work done by the subcontractor, Union Construction. Union Construction went into receivership and the receiver asserted a claim against Lundrigans for all the sums being held and which NSPC acknowledged were due. The issue before the court was:

> "What claim do the various creditors of the subcontractor, Union Construction Limited, have on the funds held back by the owner, Nova Scotia Power Corporation, from the contractor, Lundrigans Limited, under the contract between the Nova Scotia Power Corporation and Lundrigans Limited." (Page 563)

The parties who were in contest before Burchell, J. of the Trial Division were the sub-subcontractors and the bank. At page 563 he stated:

> "It will be seen that if the sub-subcontractors have no direct claim on the sum in question, any payment by the owner through to Union Construction Limited will be caught by one or the other of the securities held by the bank and, as to any surplus or other assets of Union, the sub-subcontractors will rank with Union's general creditors ..."

As in the case at bar, the Nova Scotia Power Corporation was ready to pay over the funds in accordance with an Order of the court. The argument was made by Lundrigans and the Power Corporation that there was no direct claim for the holdback because there was no contractual relationship with the Power Corporation.

Burchell, J. analyzed the law of trusts and came to the conclusion that a constructive trust existed in favor of the subcontractors and suppliers. He found that in the terms of the general contract and the subcontract there was, by necessary inference, conferred upon the owner and Lundrigans, the right to make direct payment to third party claimants due to successive failures of the subcontractor and the contractor to furnish required statutory declarations to the effect that all claims had been settled. (page 571)

The appeal decision is extremely short and reads as follows:

> "The central point in this appeal is whether the learned trial judge, Mr. Justice Burchell, was in error in finding that Nova Scotia Power Corporation is holding the sum of $213,843.70 as a holdback under the terms of the contract between it and Lundrigans Limited for the construction of the Corporation's generating station at Lingan as constructive trustee and that the beneficiaries of that trust are persons variously referred to as sub-subcontractors, job creditors or third party claimants.
>
> We are unanimously of the opinion that, with respect, the learned trial judge was in error in finding such a trust. This is not a situation in which the concept of constructive trust applies.
>
> The appeal is allowed but, in the circumstances of the case, without costs."

The submission before me is that the Union case differs from the case at bar because it involved sub-subcontractors. It was argued that setting up a constructive trust for a sub-subcontractor may not be reasonable in equity and good conscience because it is not contemplated by the main contract, whereas, subcontractors are so contemplated. Counsel referred me to the various sections in which a subcontractor is mentioned in the Conditions of Contract in the case at bar. It is submitted that the Appeal Court must have made its decision on that basis, namely: that a sub-subcontractor is simply too remote, too far removed for a constructive trust to apply; that a sub-subcontractor was not contemplated; that not only was it necessary to infer matters into the main contract in the Union case, but also into the sub-subcontract.

The Trustee in Bankruptcy submits that such a distinction, that is, between a subcontractor and sub-subcontractor, is a distinction without a difference. They submit that the Appeal Court rejected any contention that a constructive trust relates to holdbacks.

One may bemoan the fact of the brevity of the Appeal Court decision, but I am unable to place the interpretation on the Union case as proposed by the plaintiff subcontractors.

In the Bail case, the facts are that after a bankruptcy, relying upon a clause in the contract, an amount was paid directly to a supplier of materials of the company in bankruptcy. The question before the court "... is whether the contractual clause relied on can be applicable after the bankruptcy of the subcontractor ... ." The court stated at page 485:

> "In the case at bar, the supplier of materials ... is a complete stranger to the clause linking the owner and the general contractor, and between the latter and the bankrupt subcontractor."

Essentially, the court found there was no legal connection between the supplier and the owner. Thus, the supplier could not enforce a claim against either of these persons. The only claim it would have would be against the bankrupt company and its claim was neither preferred nor secured. The court held the payment made by the contractor remained a payment on behalf of a bankrupt company which the bankrupt company was not entitled to make after becoming bankrupt. (Section 50(5) of the Bankruptcy Act R.S.C. 1970 C.B. - 3) The court found, as of the date of bankruptcy, the debt had passed into the hands of the trustee as part of the property of the bankrupt company and only the trustee could receive the funds. To decide otherwise, would be to disregard the Bankruptcy Act by allowing payment of one or other of the creditors. This could give a preference to one unsecured creditor to the detriment of other secured creditors and the Act requires that any claim must be pari passu with other claims proven in bankruptcy.

In my opinion, I have no alternative but to follow the decisions found in Union Construction and Bail. I am unable to distinguish these two cases from the present fact situation. The funds presently held by the Nova Scotia Power Corporation shall be paid to Touche Ross Limited as Trustees in Bankruptcy of the Estate of Standard Construction Company Limited with pre-judgment interest at the rate and for the period as agreed to between the Trustee and the Nova Scotia Power Corporation.

The parties may speak to me on costs if required.

GLUBE C.J.T.D.

Tab 5

Case Name:

RE UNION CONSTRUCTION ET AL.

[1980] N.S.J. No. 544

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77 A.P.R. 622*

S.C.A. 00588

Nova Scotia Supreme Court Appeal Division

Cooper, Hart, Jones, Macdonald and Pace, JJ.A.

May 30, 1980

(2 pages) (3 paras.)

COUNSEL:

SIMON J. KHATTAR, Q.C., and ALAN G. HAYMAN, for the appellant, Union Construction Limited
B. WILLIAM PIERCEY, for the respondent. Irving Oil Limited and Turner's Transfer Limited
JOHN W. ARNOLD, for the respondent, Nova Scotia Power Corporation
F. B. WICKWIRE, Q.C., for the respondent, Lundrigans Limited
DOUGLAS A. CALDWELL, and DANIEL J. MacISAAC, for the respondents, Carsen's Enterprises Limited and John James Barter
The respondent County of Cape Breton was not represented

This case is an appeal from a judgment of BURCHELL, J., of the Trial Division of the Nova Scotia Supreme Court dated November 7, 1979, and reported at 41 N.S.R.(2d) 551; 76 A.P.R. 551.

This appeal was heard by COOPER, HART, JONES, MACDONALD and PACE, JJ.A., of the Appeal Division of the Nova Scotia Supreme Court at Halifax, Nova Scotia on May 30, 1980.

The judgment of the Appeal Division was delivered orally by COOPER, J.A., on May 30, 1980.

1 COOPER, J.A. [ORALLY]:-- The central point in this appeal is whether the learned trial judge, Mr. Justice Burchell, was [*page623] in error in finding that Nova Scotia Power Corporation is holding the sum of $ 213,843.70 as a holdback under the terms of the contract between it and Lundrigans Limited for the construction of the Corporation's generating station at Lingan as constructive trustee and that the beneficiaries of that trust are persons variously referred to as sub-subcontractors, job creditors or third party claimants.

2 We are unanimously of the opinion that, with respect, the learned trial judge was in error in finding such a trust. This is not a situation in which the concept of constructive trust applies.

3 The appeal is allowed but, in the circumstances of the case, without costs.

Appeal allowed.