

Goodmans^{LLP} Update

Court of Appeal Validates Statutory Trust Created by *Construction Act* Despite Bankruptcy

On January 14, 2019, the Ontario Court of Appeal released its decision in *The Guarantee Company of Canada v Royal Bank of Canada*. The decision turned on the question of whether the statutory trust created under s. 8(1) of the *Construction Act* would be recognized as a “true” trust, with the result that property subject to the trust would not be divisible among the debtor’s creditors under s. 67(1) of the *Bankruptcy and Insolvency Act* (the “*BIA*”). Justice Sharpe, writing for an unanimous panel, recognized the statutory trusts in this case, meaning that payments received on construction projects would be excluded from distributions to ordinary creditors under the *BIA*.

Background

In December of 2014, A-1, an Ontario paving company, was deemed bankrupt and a receiver (the “**Receiver**”) was appointed to realize on its assets. At the time, A-1 had four major paving projects for which there were outstanding accounts receivable. The Receiver was ordered to create a “Paving Projects Account” into which all receipts from these outstanding projects would be deposited, and the receivership order stated that the segregation of funds into the Paving Projects Account was not to augment or impair the rights of any party. The Receiver complied and payments on these projects were placed into the Paving Projects Account in a manner which allowed the funds related to each specific project to be identified.

At issue for the Ontario Court of Appeal was who had priority to the receivables collected by the Receiver. Under *Henfrey Samson*, an earlier decision of the Supreme Court of Canada, a statutory deemed trust would only survive a debtor’s bankruptcy if it was a “true” trust at common law. At common law, a “true” trust requires certainty of intention (to make a trust), object (the beneficiaries) and subject matter (identifiable assets in trust). If these three certainties were met, *Henfrey Samson* would dictate the trust property is excluded from a debtor’s estate. Generally, when assessing whether a statutory trust is a “true” trust in a bankruptcy scenario, courts have found they fail the common law test because the funds are commingled with non-trust funds (debtors usually do not open separate bank accounts for trust funds), and thus there is no certainty of subject matter.

The Royal Bank of Canada (RBC), the senior secured creditor of A-1, took the position the three certainties were not met and thus the funds in the Paving Projects Account formed part of A-1’s estate and were available for distribution to its creditors in accordance with usual bankruptcy priorities. By contrast, A-1’s bonding company, the Guarantee Company of North America (GCNA) (which was subrogated to a number of construction trust claimants it had paid under its construction bonds), and two unions representing employees, took the position the statutory trust was a true trust, and thus the funds in the Paving Projects Account were to be excluded from A-1’s property divisible amongst its creditors. To determine this issue, the Receiver brought a motion for advice and directions which was heard by the Ontario Superior Court of Justice (Commercial List).

The Lower Court Decision

In finding for RBC, the motions judge held that, because the funds in the Paving Projects Account came from multiple projects and had been mixed together into one account instead of being segregated into separate accounts, there could be no certainty of subject matter. Consequently, the motions judge held that no trust was created and the funds properly formed part of A-1’s estate and were available to A-1’s creditors.

The Ontario Court of Appeal Decision

The Ontario Court of Appeal overturned the lower court decision. Writing for the Court of Appeal, Justice Sharpe found:

- (i) the language of s. 8(1) of the *Construction Act* is sufficient to satisfy the requirement of certainty of intention to create a trust;

(ii) the statutory framework of the *Construction Act* provided the certainty of object (to protect subcontractors); and

(iii) there was certainty of subject matter because (a) the funds were held in a separate Paving Projects Account and the Receiver's records permitted a tracing of those funds; and (b) the property of the trust included identifiable accounts receivable.

Justice Sharpe also found the provincial *Construction Act*'s statutory trust provisions were not in conflict with the operation of the federal *BIA* such that the doctrine of the paramountcy of federal legislation over provincial legislation was not engaged.

Implications

This Court of Appeal decision alters the landscape in Ontario with respect to the interaction of the federal insolvency regime and provincial construction trusts. In particular, in holding: (i) the *Construction Act* itself is sufficient to provide certainty of intention; (ii) the certainty of subject matter of the trust can be established by reference to individual accounts receivable; and (iii) the *Construction Act* trust regime does not conflict with the federal bankruptcy priorities established by the *BIA*, the decision provides a broadened opportunity to those who supply labour, services and materials to the construction industry to pursue a priority recovery of funds owing to a debtor under a construction contract when a bankruptcy occurs.

The tension between the *BIA* and the *Construction Act* has long existed. Construction contract receipts can no longer automatically be considered to be available to the creditors of a bankrupt, but rather a path exists for them to remain within the construction pyramid. While the Court of Appeal's reasoning is fact specific, this decision is likely to have wide ranging implications for construction companies, lenders and creditors and may also impact the approach courts take in the future when considering the interaction of the *BIA* and other provincial statutory trusts.

As of the date of writing, there is no indication that leave to appeal to the Supreme Court of Canada has been sought.

For further information on this case, please contact: [Howard Wise](#), [Joseph Cosentino](#), [Joe Latham](#), [Brad Halfin](#) or [Amanda Bertucci](#).