***Veltri Metal Products Co. (Re)*: The Death of *Minneapolis-Honeywell*?**
Case Comment by Duncan W. Glaholt

For the past 50 years, provincial trust legislation has relied upon the concept of "deemed receipt" to ensure that the statutory construction trust could not be defeated by the simple expedient of a general assignment of book debts. It is upon this foundation that the statutory construction trust rests. Without it, the statutory construction trust is meaningless.

The result in the July 29, 2005 decision of the Ontario Court of Appeal in a *Companies' Creditors Arrangement Act* case, *Veltri Metal Products Co. (Re),* [2005] O.J. No. 3217, casts significant doubt on the applicability of the concept of "deemed receipt" in Companies' Creditors Arrangement proceedings, and, thus, on the continued utility of the statutory construction trust itself. In other words, if *Veltri* is correct, companies sufficiently mismanaged (intentionally or not) so as to be entitled to reorganize under the *Companies' Creditors Arrangement Act* will be able to avoid entirely Part II of the *Construction Lien Act* and leave their trades and suppliers without a remedy. If no trust arises in such circumstances, there can be no personal liability under s. 13 for corporate breach of the statutory trust.

The issue:

The judicial construct of deemed receipt was first articulated by the Supreme Court of Canada in their landmark 1955 decision in *Minneapolis-Honeywell Regulator Co. v. Empire Brass Manufacturing Co.*[1]on appeal from the British Columbia Court of Appeal.

The case arose at trial as an action by Minneapolis-Honeywell for an accounting of moneys claimed to be held in trust by Empire Brass under s. 19 of the *Mechanic's Lien Act*, R.S.B.C. 1948, c. 205. Section 19 provided as follows:

> *All sums received* by a contractor or a sub-contractor on account of the contract price shall be and constitute a trust fund in the hands of the contractor or of the sub-contractor, as the case may be, for the benefit of the owner, contractor, sub-contractors, Workmen's Compensation Board, labourers, and persons who have supplied material on account of the contract; and the contractor or the sub-contractor, as the case may be, shall be the trustee of all such sums so received by him, and, until all labourers and all persons who have supplied material on the contract and all sub-contractors are paid for work done or material supplied on the contract and the Workmen's Compensation Board is paid any assessment with respect thereto, shall not appropriate or convert any part thereof to his own use or to any use not authorized by the trust. (emphasis added)

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[1] [1955] S.C.R. 694 (S.C.C.)

Compare the contractor's trust of section 8 of the current *Construction Lien Act*:

> *Contractor's and subcontractor's trust,*
> *amounts received a trust*
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> 8.--(1) All amounts,
>
> (a) owing to a contractor or subcontractor, whether or not due or payable; or
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> (b) received by a contractor or subcontractor,
>
> on account of the contract or subcontract price of an improvement constitute a trust fund for the benefit of the subcontractors and other persons who have supplied services or materials to the improvement who are owed amounts by the contractor or subcontractor.
>
> *Obligations as trustee*
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> (2) The contractor or subcontractor is the trustee of the trust fund created by subsection (1) and the contractor or subcontractor shall not appropriate or convert any part of the fund to the contractor's or subcontractor's own use or to any use inconsistent with the trust until all subcontractors and other persons who supply services or materials to the improvement are paid all amounts related to the improvement owed to them by the contractor or subcontractor.

Minneapolis-Honeywell had a subcontract to a mechanical sub-contractor, Irvine and Reeves Ltd., to supply and install automatic heating controls. Empire Brass was a wholesale dealer in plumbing and heating supplies. Irvine and Reeves Ltd. (not a party to the proceedings at any level) had run up a debt of $19,278.41 with Empire Brass on other projects. Empire Brass declined to supply Irvine and Reeves Ltd. on four new school projects without a general assignment of their present and future book debts. The assignment was given, the general contractor was duly notified. Subsequently, all payments on the four projects (including amounts attributable to the supply and installation of automatic heating controls by Minneapolis-Honeywell) were paid by joint cheque to Irvine and Reeves Ltd. and Empire Brass. These two would sit down when a cheque arrived and decide what accounts on the four schools got paid, and what was left over to apply to old indebtedness. As was later observed judicially, this gave Empire Brass complete control over the business of Irvine and Reeves Ltd.

Minneapolis-Honeywell let its lien rights lapse and proceeded instead to personal judgment for the money owed to it and an accounting under the trust sections of the British Columbia lien legislation quoted above.

Subsequently Irvine and Reeves Ltd. "went into liquidation".

The trial judge found that Irvine and Reeves Ltd. were subcontractors within the meaning of s. 19, that the assignment of book debts secured a specific indebtedness which had been extinguished by payments, and that any further moneys received by the respondent were subject to the trust declared by s. 19. A reference was directed to ascertain the amounts subject to such trust and the respective rights of the parties. The Court of Appeal, by a majority, reversed on the narrow basis that any rights which s. 19 purported to give could be invoked only by a person who was, at the time of the institution of the action, entitled to a lien upon the property in respect of which the work had been done or the materials supplied. The case went to the Supreme Court of Canada on all points.

Rand J. for himself, Kellock, Estey and Fauteux JJ. held on the issue of the trust and assignment of book debts that:

> I am unable to feel difficulty about what this language [s. 19 of B.C.'s 1948 lien statute, imposing a statutory trust on monies "received" by a contractor] provides. The Act is designed to give security to persons doing work or furnishing materials in making an improvement on land. Speaking generally, the earlier sections give to such persons a lien on the land, but that is limited to the amount of money owing by the owner to the contractor under the contract when notice of the lien is given to him: only thereafter does he pay the contractor at any risk.
>
> For obvious reasons this is but a partial security; too often the contract price has been paid in full and the security of the land is gone. It is to meet that situation that s. 19 has been added. The contractor and sub-contractor are made trustees of the contract moneys and the trust continues while employees, material men or others remain unpaid.
>
> The appellants were, therefore, *cestuis que trust* of the moneys received by the sub-contractor. The mode of payment followed by the contractor toward the sub-contractor, Irvine & Reeves Limited, and the respondent is given in the reasons of my brother Locke and I will not repeat it; but apart from the special features, I cannot interpret the word "received" in s. 19 as not including money paid to an assignee. *The money "received" on account of the contract is the same as that paid by the contractor: payment the correlative of receipt.* The assignee acts through the right and power of the assignor; and the receipt by him is likewise that by the creditor. If this were not so, the entire purpose of the section could be nullified by an assignment contemporaneous with the contract. S. 16 declares that

> no assignment by the contractor or any sub-contractor of any moneys due in respect of the contract shall be valid as against any lien given by this Act . . .
>
> But this does not prevent valid payment to the assignee prior to a notice of lien. The statute contemplates payments to the contractor whether direct or to his assignee, but these remain subject both to s. 16 as respects liens and to s. 19 as to the beneficiaries of the trust. The assignee of such moneys must either see to the satisfaction of the rights under the trust, either directly or by way of subrogation to them, or run the peril of participating in a breach of it. I have no doubt that no assignment can destroy the rights created by s. 19 in the moneys so paid over. (emphasis added)

In the result, the court amended the trial judgment to provide, *inter alia*:

> (a) A declaration that Empire Brass was a party to a breach of trust in relation to such part of the moneys represented by the joint cheques received, directly or indirectly, in excess of and applied otherwise than on the accounts of the four contracts severally;
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> (b) An account to determine the amount of the trust funds received by Empire Brass and Minneapolis-Honeywell in respect of the contracts severally and their application;
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> (c) An account to determine the balance owing by the Irvine and Reeves Ltd. to Empire Brass and Minneapolis-Honeywell on each of the four contracts after allocation, severally, of all applicable trust funds received by them;

Locke J. dissented in the Supreme Court of Canada. He noted that the majority of the British Columbia Court of Appeal had found that the claim of Empire Brass depended entirely on the terms of the written assignment and that the matter was simply a matter of the construction of the language of the written assignment itself. He held that by reason of the assignment, the moneys received by Empire Brass were the property of Empire Brass and were *not* "received" by Irvine and Reeves Ltd. and hence were not any time subject to the trust.

The concept of "deemed receipt" quickly took root. It has been applied uniformly across Canada since 1955, forming the foundation stone of the modern law of statutory construction trusts.[2]

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[2] See *Pilkington Glass Ltd. v. Burnaby S.D.* (1961), 36 W.W.R. 34 (B.C. S.C.); *Wall Bros. Const. Co. v. Canson Enterprises Ltd.* (1987), 26 C.L.R. 177 (B.C. Co. Ct.); *B.C. Hydro & Power Authority v. Hallcraft*

With the unanimous July 29, 2005 decision of the Ontario Court of Appeal in *Veltri Metal Products Co. (Re)*, [2005] O.J. No. 3217, however, it appears that there might be some life left in Justice Locke's fifty year old dissent and that *Minneapolis-Honeywell* must now be qualified in the case of distribution of sale proceeds under the *Companies' Creditors Arrangement Act*. Whether *Veltri* is an intentional departure from *Minneapolis-Honeywell* remains to be seen as *Minneapolis-Honeywell* is not mentioned in any of the facta filed, nor is it referred to in the reasons of the Court of Appeal.

Veltri

Veltri was an automobile parts maker. It operated a number of plants in Ontario, including the "Lakeshore Plant" leased from Obolus Limited. Veltri was financed by a syndicate (represented by Comerica) and owed its lenders $67,556,527 (U.S.).

In mid-May, 2003 Veltri hired AC Metal to work on the Lakeshore Plant. In October, 2003 Veltri hired De Angelis to build several foundations and pits. De Angelis was certified substantially by December 29, 2003.

By mid-January, both Veltri and De Angelis had liened Veltri's leasehold interest.

Veltri sought CCAA protection.

On January 13, 2004 Justice Spence issued the Initial CCAA Order appointing Ernst & Young Inc. as Monitor, authorizing $9.75 million (Cdn.) in debtor-in-possession financing with GMAC Commercial Finance, and authorizing Veltri to execute and deliver GMAC "all such security and ancillary documents . . . charging all of [Veltri's] existing and after-acquired assets, property and undertaking".

Construction Co. (1986), 6 B.C.L.R. (2d) 74 (S.C.); *Modular Products Ltd. v. Aristocratic Plywoods Ltd.; Modular Products Ltd. v. R,*. [1974] 2 W.W.R. 90 (B.C. C.A.); *Royal Bank v. Wilson* (1963), 42 W.W.R. 1 (Man. C.A.); *Re Northwest Elec. Ltd.*, [1973] 3 W.W.R. 156 (B.C. S.C.); *Cronkhite Supply Ltd. v. W.C.B.* (1976), 1 B.C.L.R. 142, affirmed in part (1978), 91 D.L.R. (3d) 423, affirmed on other grounds (*sub nom. W.C.B. v. Cronkhite Supply Ltd.*), [1979] 2 S.C.R. 27; *Crane Can. Ltd. v. McBeath Plumbing & Heating Ltd.* (1965), 54 W.W.R. 119 (B.C. S.C.); *Atlas Glass Co. v. Superior Components Ltd.*, [1976] W.W.D. 109 (B.C. Co. Ct.); *Ledingham Properties Ltd. v. Const. Cartage Co.* (1981), 29 B.C.L.R. 155 (C.A.); *A & M Painting Contractors Ltd. v. Byers Const. Western Ltd.* (1981), 122 D.L.R. (3d) 355 (B.C. C.A.); *Metro Electrical Contractors Ltd. v. Poorman*, [1988] 2 W.W.R. 163 (Sask. Q.B.); *Wall Bros. Const. Co. v. Canson Enterprises Ltd.* (1986), 70 B.C.L.R. 243 (B.C. C.A.); *Wall Bros. Construction Co. v. Canson Enterprises Ltd.* (1987), 26 C.L.R. 177 (B.C. Co. Ct.); *Greater Vancouver Water Dist. v. P & P Excavation Ltd.* (1984), 10 C.L.R. 249 (B.C. S.C.); *Re Certain Lands in West Vancouver* (1963), 43 W.W.R. 181 (B.C. S.C.); *Requip (Niagara Falls) Ltd. v. Fort Erie; Salit Steel (Niagara) Ltd. v. Penn-Mac Const. Co.* (1984), 7 C.L.R. 134 (Ont. H.C.); *First City Savings & Trust Co. v. Jovanovich* (1983), 40 O.R. (2d) 161 (H.C.); *Re Schulz Concrete Pipe Ltd.* (1979), 32 C.B.R. (N.S.) 157 (Ont. S.C.); *Western Caissons (Sask.) Ltd. v. Buildall Const. Ltd.* (1978), 81 D.L.R. (3d) 664, affirmed [1978] 5 W.W.R. 765 (Sask. C.A.); *A & M Painting Contractors Ltd. v. Byers Const. Western Ltd.* (1981), 122 D.L.R. (3d) 355 (B.C. C.A.); *Metro Electrical Contractors Ltd. v. Poorman*, [1988] 2 W.W.R. 163 (Sask. Q.B.); *Wall Bros. Const. Co. v. Canson Enterprises Ltd.* (1986), 70 B.C.L.R. 243 (B.C. C.A.); *Wall Bros. Construction Co. v. Canson Enterprises Ltd.* (1987), 26 C.L.R. 177 (B.C. Co. Ct.); *Greater Vancouver Water Dist. v. P & P Excavation Ltd.* (1984), 10 C.L.R. 249 (B.C. S.C.).

The Monitor applied for and on April 28, 2004 Justice Spence issued a Sale Order authorizing the sale of all of Veltri's assets to the similarly named "Ventra" for $48.077 million (U.S.) subject to adjustments.

The Sale Order expressly provided that the vesting was free and clear of and from any and all right, title, and interest of [Veltri] and of, security interests, charges, estates, licenses, trusts, deemed trusts (whether contractual, statutory or otherwise) and [other encumbrances] . . . whether contractual, statutory, by operation of law or otherwise, whether secured, unsecured or otherwise . . .".

The Sale Order also expressly provided that:

> 12. THIS COURT ORDERS that the Cash Purchase Price, subject to (a) the holdbacks and adjustments, and (b) net of payment of those obligations and expenses required to be made by [Veltri] in each case, made pursuant to the [Sale] Agreement ("Net Proceeds of Sale") shall stand in place and stead of the Acquired Assets without prejudice to any claim being advanced against them as could have been advanced against such assets and any such claim against the Net Proceeds of Sale as may be approved and valued by this Honourable Court in subsequent proceedings shall be subject to the same priorities as could have been claimed against the Acquired Assets.

There was a substantial shortfall for the secured creditors, however the Monitor agreed to hold $1,277,297.91 (Cdn.) out of the sale proceeds, together with any interest earned thereon, pending further court order or other disposition of various claims including those of Veltri and De Angelis.

On June 16, 2004, Veltri and De Angelis moved before Justice Farley for orders compelling payment of their lien claims from the proceeds of sale, citing the owner's trust, ss. 7 (1), (2), and (3) and the vendor's trust, s. 9 of the *Construction Lien Act* as follows:

> S. 7 (1): <u>All amounts received by an owner</u>, other than the Crown or a municipality, <u>that are to be used in the financing of the improvement</u>, including any amount that is to be used in the payment of the purchase price of the land and the payment of prior encumbrances, constitute, subject to the payment of the purchase price of the land and prior encumbrances, a trust fund for the benefit of the contractor.
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> (2): <u>Where amounts become payable under a contract to a contractor by the owner on a certificate of a payment certifier</u>, an amount that is equal to an amount so certified that is in the owner's hands <u>or received by the owner at any time thereafter</u> constitutes a trust fund for the benefit of the contractor.

> (3): <u>Where the substantial performance of a contract has been certified</u>, or has been declared by the court, an amount that is equal to the unpaid price of the substantially performed portion of the contract that is in the owner's hands <u>or is received by the owner at any time thereafter</u> constitutes a trust fund for the benefit of the contractor.
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> (emphasis added)
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> S. 9 (1): Where the owner's interest in a premises is sold by the owner, an amount equal to,
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> (a) the value of the consideration received by the owner as a result of the sale,
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> less,
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> (b) the reasonable expenses arising from the sale and the amount, if any, paid by the vendor to discharge any existing mortgage indebtedness on the premises,
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> constitutes a trust fund for the benefit of the contractor.

Justice Farley held that Veltri and De Angelis had no valid trust claim. He was upheld in the Court of Appeal.

The Court of Appeal reasoning can be summarized as follows:

(a) S. 7(1): There was a factual determination in the court below, granted considerable deference, that there was no evidence that Comerica's funds or the DIP funds were to be used "in the financing of an improvement". This is a pre-condition of liability under s. 7 (1).

(b) S. 7(2)(3):

- (i) The "Net Proceeds of Sale" were not "in the owner's hands" or "received" by the owner as they had bypassed the owner and gone directly to the Monitor;
- (ii) "Payment or performance certification" for the AC Metal work was not forthcoming until June, 2004 <u>after</u> the asset sale had taken place and "the net sale proceeds were paid or payable to the court-appointed Monitor".

(c) S. 9:

- (i) There was no showing before the motions judge that Veltri's leasehold interest in the Lakeshore Plant had any value;
- (ii) The net proceeds of sale realized on the asset sale to Ventra were not "received" by Veltri as owner of the property sold, and were not

> "consideration received by the owner as a result of the sale" within the meaning of s. 9(1)(a) of the Act. At best, Veltri was a "conduit" for the receipt by the Monitor of the sale proceeds.

<u>What is the meaning of "received" (Court of Appeal reasons points (b)(i) and (c)(ii))</u>?

Unless *Minneapolis-Honeywell* can be distinguished, the concept of "deemed receipt" would appear to provide a complete answer to the Court of Appeal's reasoning in points (b)(i) and (c)(ii) above.

At least two facts might distinguish *Minneapolis-Honeywell*:

(a) *Minneapolis-Honeywell* was a "contractor's trust" case: *Veltri* is an "owner's trust" case;

The operative mechanism in the 1948 British Columbia *Mechanic's Lien Act* s. 19 (contractor's trust) and the 1990 Ontario *Construction Lien Act* s. 7(2) (owner's trust) is exactly the same: receipt. *Minneapolis-Honeywell* decides that money "received" on account of the contract is the same as that paid by the contractor. As Rand J. put it for the majority in *Minneapolis-Honeywell*, "payment the correlative of receipt". The assignee acts through the right and power of the assignor; and the receipt by the assignee is likewise that by the creditor.

(b) *Minneapolis-Honeywell* was a voluntary liquidation: *Veltri* was expressly statutory liquidation;

This should be no basis for distinction when the *Companies' Creditors Arrangement Act* requires that it be so. It does not appear that counsel considered it was a basis for distinction when they took care to preserve the rights of the parties in their Sale Order (i.e. the Net Proceeds of Sale shall ". . . stand in the place and stead of the Acquired Assets without prejudice to any claim being advanced against them as could have been advanced against such assets . . . "). Why do this if the *Companies' Creditors Arrangement Act* clearly excluded deemed receipt?

It is relatively well established that the purpose of the *Companies' Creditors Arrangement Act* is not to give a benefit or advantage to one class of creditors at the expense of other creditors. Likewise, it is the duty and the responsibility of the court not to alter the security arrangements entered into by the debtor company and its creditors. It is not the court's duty, responsibility or mandate, for example, to attempt to readjust the priorities between the creditors and the applicant companies. Where, for example, it is acknowledged that monies are held in trust for construction creditors, they do not form part of the estate of the company in liquidation, notwithstanding the

> provisions of the *Companies' Creditors Arrangement Act* (per: Chadwick J. in *Canadian Asbestos Services Ltd. et al. v. Bank of Montreal et al.* (1992), O.R. (3d) 353, [1992] O.J. No. 2320 at p. 7, citing: *Chef Ready foods Ltd. v. Hong Kong Bank of Canada* (1990), 4 C.B.R. (3d) 311, 51 B.C.L.R. (2d) 84 (C.A.); *Elan Corp. v. Comiskey* (1990), 1 O.R. (3d) 289, 1 C.B.R. (3d) 101 sub nom. *Nova Metal Products v. Comiskey* (C.A.)).

No evidence that the competing creditor's monies were used "in the financing of the improvement" (Court of Appeal reasons on s. 7(1), point (a) above):

Whether it is plausible or not that some of Comerica's money was intended to be used in the financing of the improvement, the Court of Appeal's conclusion on this point is an inversion of the customary burden of proof. How any stranger to the financing could be expected to marshall sufficient evidence to discharge the burden of proof imposed by the Court of Appeal is hard to understand. The party with exclusive means to discharge the burden should be the party that bears the burden, in this case Comerica and the Monitor. Their documentation would have been created before there was any sensitivity to the statutory trust issue and should therefore be most reliable. At common law, the established rule has always been that when the subject-matter of an allegation lies particularly within the knowledge of one of the parties, that party must prove it, whether it is affirmative or negative in character.[3] Where information is manifestly beyond the power of a party to discover and prove in evidence, and where that party demonstrates that the information is not in its possession and is peculiarly within the other party's knowledge, usually the other party bears the burden of proof.[4]

It is better to read this portion of s. 7(1) as a defense, not a claim.

"Payment or performance certification" was not forthcoming until after the asset sale had taken place and the net sale proceeds were paid or payable to the court-appointed Monitor (Court of Appeal reasons, s. 7(2) & (3), point (b)(ii) above):

This is hard to reconcile with the stated facts of the case. It would appear that "substantial performance" was certified on December 29, 2003 (under s. 7(3) of the *Construction Lien Act*) and that the asset sale did not take place until after the Sale Order on April 28, 2004. It may be that final contractual "*performance* certification" of the new work did not take place until later, but this is not usually the precise equivalent payment certification under a contract, except, perhaps for a specific (small) performance related holdback.

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[3] See *Hoffman-La Roche Ltd. v. Apotex Inc*. (1983), 71 C.P.R. (2d) 20 (Ont. H.C.); affirmed (1984), 1 C.P.R. (3d) 507 (Ont. C.A.); leave to appeal denied (1985), 2 C.P.R. (3d) 431n (S.C.C.).

[4] See *Pfizer Canada Inc. v. Apotex Inc*., [2004] F.C.J. No. 326 (Fed. Ct.). See also *Taylor Estate v. Wong Aviation Ltd.*, [1969] S.C.R. 481; J. Sopinka, S.N. Lederman, A.W. Bryant, *The Law of Evidence in Canada* (Toronto: Butterworths, 1999) at §3.74.

There was no showing before the motions judge that Veltri's leasehold interest in the Lakeshore Plant had any value (Court of Appeal reasons, s. 9, point (c)(i) above):

How would a beneficiary, who has no control, ever prove such a thing? It would be all too easy for a statement of adjustments to ascribe no value to a lease. Once again this should be treated as a matter of defense, not claim. The party with the means to satisfy the burden should bear the burden. The unsatisfactory alternative is for the lien claimants to summons evidence on a motion, likely obtain the wrong witness and documents, if any, and stand exposed for considerable costs. If the vendor's lease has no benefit or value to the purchaser, it should be a relatively easy task for them to prove this from existing business and other records.

Conclusion:

As it stands, *Veltri* appears to render the statutory construction trust nugatory in CCAA reorganizations. There is nothing unusual in either the Initial Order or the Sale Order in *Veltri* to allow *Veltri* to be distinguished in later cases. If *Veltri* is correct, no monies will ever be "received" within the meaning of Part II of the *Construction Lien Act* following an Initial Order under the CCAA. It is a shame that *Minneapolis-Honeywell* was neither considered nor distinguished in reaching this result.