Comstock Canada Ltd. (Re), A Model of Efficiency

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Comstock, A Model of Efficiency[1]

I. Introduction

With the number of insolvencies[2] in the construction sector generally remaining at a constant number, there is a growing need for the orderly and efficient administration of insolvency proceedings of insolvent construction sector companies. However, when a construction sector company initiates insolvency proceedings, there appears to be a degree of panic due to the uncertainty brought on by the typical stay provisions that prevent creditors from commencing an action against the insolvent company or that prevent creditors from preserving and perfecting lien rights. In addition, and for good reason, the trade creditors fear that there may be no prospect of recovering any amount from the insolvent company.

In an endorsement made in the course of the Comstock Canada Ltd. *CCAA* proceedings, Justice Morawetz commented on the unique nature of insolvencies in the construction sector as follows[3]:

> This motion underscores the inherent difficulty which surrounds the attempted reorganization of certain entities, in particular, real estate companies and construction companies. By definition real estate companies and construction companies operate on a project-by-project basis. In many cases, each project is the subject of specific-purpose financing. In the case of real estate companies, secured creditors vary on a project-by-project basis. With respect to construction companies, creditors, including construction lien trust claimants, vary on a project-by-project basis and the assets or trust funds also vary on a project-by-project basis. The legal rights of these creditors vary to such a degree that quite often they cannot be grouped in one class. The community of interest is often lacking, resulting in fragmented interests.

The Comstock Canada Ltd. insolvency proceeding in some respects represents a high-water mark in construction insolvencies as it eventually applied recognized insolvency principles, did away with lien proceedings yet also provided an orderly and efficient process for the administration of claims made by Comstock's trade creditors. The court orders obtained in the Comstock insolvency were perceived as unusual and perhaps even unconstitutional.[4] However, when the Comstock insolvency is approached from the perspective of trade creditor rights in the course of an ordinary default on a project, the Comstock insolvency proceeding may be viewed

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[1] John Margie, Partner, Glaholt LLP.

[2] This paper only addresses insolvency proceedings under the *Companies' Creditors Arrangement Act*, RSC 1985, c. C-36 ("*CCAA*") and proposals under the *Bankruptcy and Insolvency Act,* RSC, 1985, c. B-3 ("*BIA*"). It does not address bankruptcies or receiverships, whether private or Court appointed receivers.

[3] *Comstock Canada Ltd. (Re)* (2013), 33 CLR (4th) 336 (Ont Sup Ct) at para 16.

[4] Whether the Orders, and in particular the Lien Regularization Order, were unconstitutional is outside the scope of this paper.

as providing an orderly and efficient process for the administration of trade creditor claims and the administration of the insolvent debtor.

Using the Comstock insolvency proceeding as the model, with some additional tweaking, the insolvencies of construction sector companies (real estate developers and construction companies) would be made more orderly and efficient and provide a level of certainty with respect to the process.

This paper is divided into five main parts. The first part is a brief statistical analysis of the construction sector proposals under the *BIA* and insolvencies under the *CCAA*. The second part addresses a default by a construction sector company in the ordinary course (not a proposal or insolvency) and the expectations of parties involved. The third part addresses some of the established principles in insolvency proceedings and how they affect construction sector creditors. The fourth part addresses the insolvency proceeding of Comstock and the final part provides suggestions for enhancing the efficiency of construction sector insolvencies.

II. Statistical Analysis of Insolvencies in Canada

Industry Canada divides the Canadian economy into twenty sectors. These sectors are further classified into two divisions, the goods-producing industries and the services-producing industries.[5] The construction sector is part of the goods-producing industries and is divided into three main categories: construction of buildings; heavy and civil engineering construction; and specialty trade contractors. Each of the three categories is further subdivided into several classifications.[6] The further classifications attempt to capture every aspect of the construction industry within the definition of "construction" used by Industry Canada. For example, the first of the three main categories, the construction of buildings, is further classified into residential and non-residential buildings with non-residential buildings being categorized into industrial building and structure construction and commercial and institutional building construction.[7]

As at August 2013, the construction sector, as defined by Industry Canada, represented 7% of the Canadian economy.[8] Between 2009 and 2013, the construction sector as a value of the Canadian economy grew by 18%. No doubt this growth is, in part, a result of the stimulus programmes by the Federal and Provincial governments following the global financial crisis.

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[5] Industry Canada, https://www.ic.gc.ca/app/scr/sbms/sbb/cis/definition.html?code=11-91&lang=eng%22 .

[6] The other categories are as follows: Heavy and civil engineering construction encompasses utility system construction (further categorized as water and sewer line and related structures construction, oil and gas pipeline and related structures construction and power and communication line and related structures construction), land subdivision, highway, street and bridge construction and other heavy civil and engineering construction. The specialty trade contractors segment is further divided into foundation, structure and building exterior contractors, building equipment contractors, building finishing contractors and other specialty trade contractors.

[7] Industry Canada, http://www.ic.gc.ca/eic/site/cis-sic.nsf/eng/00062.html. See also, Industry Canada, Definition, data sources and methods for a full description of the "Construction" classification under the North American Industry Classification System (NAICS) 2007: http://stds.statcan.gc.ca/naics-scian/2007/cs-rc-eng.asp?criteria=23.

[8] Statistics Canada, http://www.statcan.gc.ca/tables-tableaux/sum-som/l01/cst01/gdps04a-eng.htm .

Despite the growth of the construction sector, the number of construction industry proposals[9] increased as compared to the total number of proposals in all industries in Canada. In 2009 there were a total of 166 proposals by construction sector companies. The number of proposals in the construction sector in 2009 represented a total of 12.7% of all proposals in Canada. By 2013, the number of proposals in the construction sector had increased to 184.[10] The 184 proposals represents an increase of only some ten per cent from the 166 proposals recorded in 2009. However, over the same period, the number of proposals in the construction sector had increased to 16.8% as compared to the total number of all proposals in Canada.[11]

In addition, since 2009, there has been a slight increase in the value of declared liabilities as at the time of filing suggesting that the proposals in the construction sector are becoming larger by liabilities. This does not bode well for creditors of the insolvent owner developer (referred to by Justice Morawetz as the real estate company) or the insolvent construction company.

Statistics related to insolvency proceedings commenced under the *CCAA* are separately maintained by the Office of the Superintendent in Bankruptcy from the statistics related to proposals under the *BIA*. The statistics in respect of insolvency proceedings commenced under the *CCAA* by construction sector companies as compared to all insolvency proceedings commenced in Canada are not much different from the statistics related to proposals. The percentage of insolvency proceedings commenced under the *CCAA* by construction sector companies has remained generally at 15.5% to 18%[12] of all insolvency proceedings commenced in Canada.

The data generally suggests that as the construction sector grew as a part of the Canadian economy, there was an increase in the number of proposals in the construction sector as compared to all insolvencies in Canada. This may, in part, be explained by the project-by-project form of financing adopted by the construction sector companies noted in the Comstock *CCAA* proceedings by Justice Morawetz.[13] It may also be explained by the protective structures adopted by most construction sector companies. On February 22, 1989, at a meeting of the Construction Law and Insolvency Law sections of the Canadian Bar Association, a representative of a large accounting firm noted that due to the high rate of bankruptcies on construction projects resulting from such issues as shortage of capital, poor estimating or lack of

[9] The Office of the Superintendent of Bankruptcy, Canada keeps separate statistics related to bankruptcies and proposals under the *BIA* and insolvency proceedings commenced under the *CCAA*. The statistics set out in this paragraph relate to bankruptcies and insolvencies.

[10] In 2012, the number of proposals under the *BIA* by construction sector companies peaked at 226 proposals. In 2012, proposals by construction sector companies represented 20.2% of all proposals made in Canada.

[11] The figures for proposals in Canada do not include numbers for court and privately appointed receivers. In addition, the receivership figures are not tracked by sector.

[12] Industry Canada, http://www.ic.gc.ca/eic/site/bsf-osb.nsf/eng/h_br01011.html; These percentages cover the years 2010 to 2013. The year 2011 saw a sharp decline as there was only one construction sector company insolvency proceeding commenced.

[13] See *supra* note 3.

supervisory ability, among others, "project participants should ensure that corporate structures are set up to minimize the assets put at risk in any given venture."[14]

With the increase in the percentage of proposals and insolvencies in the construction sector, a need arises for the efficient and orderly administration of the insolvency proceedings of construction sector companies. This would give all players in the construction sector a better understanding of the process and establish an administration process that is certain with the intention that the flow of funds continues unabated and projects are completed.

III. Ordinary course default

Where there is a default on a construction project in the ordinary course, the lien legislation in the Provinces and the case authorities provide guidance related to the expectation of recovery of amounts owing to the trade creditors by the defaulting party. The expectation of trade creditors can be addressed by looking at the typical or ordinary course default of an owner, a contractor or a subcontractor, where the defaulting party has not resorted to any type of insolvency proceeding. Simply put, the owner, contractor or subcontractor has stopped paying or performing and simply disappeared.

a) Owner defaults

Where an owner developer (real estate company) defaults so that it no longer makes payments to its contractor and the mortgagee has stepped in or is about to step in and take control of the project and either sell the property under a power of sale or foreclose, the contractor and its trades will no doubt take steps to preserve and perfect liens. Irrespective of the state of accounts as between the defaulting owner and the contractor, when a contractor and its trades rely on the lien remedy and the defaulting party is the owner, the liability of the mortgagee with a building mortgage is limited to any deficiency in the holdback that the owner is required to maintain.[15] Therefore in this scenario, when a lien remedy is used, the expectation of any recovery by the contractor and its trades should be limited to the holdback that the owner should have retained.[16]

If the mortgagee sells the property and the proceeds of sale exceed the outstanding mortgage amount, then the balance of the proceeds of sale may be distributed to the lien claimants. If however, there is a shortfall so that the mortgagee does not recover the amount owing on the mortgage, then the lien claimants can expect to receive no more than the deficiency in holdback that should have been retained by the defaulting owner. The likelihood of any surplus will be determined by the state of completion of the defaulting owner's project.

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[14] "Insolvency of the General Contractor on a Construction Project: CBAO Construction Law/Insolvency Law Sections, Summary of Joint Meeting" (1990) 35 CLR 256.

[15] See s. 23(1) of the Ontario *Construction Lien Act,* 1990, RSO, c C.30.

[16] See for example s. 78(2) of the *Construction Lien Act* that limits the liability of a mortgagee of a building mortgage to a deficiency in the holdback that should have been retained by the owner. See also *Basic Drywall Inc. v 1539304 Ontario Inc.,* 2012 Carswell Ont 2566 (Ont SCJ); aff'd 2012 Carswell Ont 16493 (Ont Div Ct).

The contractor can also make a claim for breach of trust under Part II of the *Construction Lien Act*. The contractor will make its breach of trust claim against the company, the officers and directors of the company and those in control of the company.[17] However, the contractor's recovery may be limited depending on the manner in which the owner developer has arranged its business affairs.

Generally, as privity of contract is a required element for a breach of trust action,[18] this remedy will not be available to the trade creditors as against the developer owner, however the trade creditors could avail themselves of this remedy as against the contractor, provided the contractor has received funds from the owner developer on account of the project and has not paid its trades.[19] If the defendant contractor can prove that it did not misappropriate the trust funds, the subcontractor will not be able to recover any amount from the contractor. In any event, any recovery by the trade creditors under a breach of trust claim may be uncertain and may be affected by a pay-when-paid clause.

If the contractor has provided a labour and material payment bond to the owner, the trades that are claimants may make a claim under the payment bond. However, if the subcontracts between the contractor and the trades contain pay-when-paid clauses, the trades' recovery under the payment bond will likely be limited. [20]

b) Contractor defaults

Where the defaulting party is the contractor, and assuming that the owner has made all payments to its contractor except for the holdback and the most recent or last draw, where the trade creditors register liens, the owner's liability is limited to the holdback plus any earned and unpaid amount.[21] However the owner is permitted to assert a set-off against the amounts earned by and unpaid to its contractor, but in no event will the set-off affect the owner's holdback liability.[22] As such, assuming the owner has valid set-offs against the earned and unpaid amounts, then the trade creditors can expect to receive no more than the statutory holdback retained by the owner from its contractor.

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[17] See ss. 7, 8 and 13 of the *Construction Lien Act.*

[18] See *Edwards Stephens Associates Ltd. v G.L. Trenching Ltd.* (1989), 73 OR (2d) 112 (Ont SC, H Ct J).

[19] See s. 8 of the *Construction Lien Act.* See also *Sunview Doors Ltd. v Academy Doors & Windows Ltd.,* [2010] O.J. No. 1043 (Ont CA) where the Court of Appeal set out the four elements that must be proven to establish a claimant is a beneficiary of a trust under s. 8(1) of the *Construction Lien Act.*

[20] If the pay-when-paid clause only affects the timing of payment and does not represent a true condition precedent to payment, the surety's ability to rely on that clause may be limited. See *Tam-Kal Ltd. v Stock Mechanical Inc.,* [1998] OJ No 4577 (Ont Gen Div) on the distinction between a true condition precedent pay-when-paid clause (or "paid-if-paid") and a clause only intended to relate to the timing and process of payment. See also *Arnoldin Construction & Forms Ltd. v Alta Surety Co.,* [1995] NSJ No 43 (NS CA), leave to appeal to SCC refused without reasons, (1995), 193 NR 320 (SCC) at para. 28, on the requirement of clear language for a true "paid-when-paid" clause to be enforceable as a true condition precedent.

[21] See s. 23(2) of the *Construction Lien Act.*

[22] See s. 17(3) of the *Construction Lien Act.*

Master Albert explained the purpose of holdback funds in a case between a homeowner and a subcontractor following the default and disappearance of the contractor:

> The purpose of holdback funds is to protect a subcontractor who has no direct contractual relationship with the property owner who presumably benefited from their work and services. Subcontractors may claim against holdback funds for unpaid services. Where the lien claims of all subcontractors on a job exceeds the amount of the holdback funds then the subcontractors share in the holdback funds on a pro rata basis.[23]

In addition, under this scenario, even if the subcontractors register liens, their liens may be defeated by Canada Revenue Agency's super-priority[24] and if the super priority is exercised to its full extent by the Canada Revenue Agency, this may leave no amount for distribution to the trade creditors.

The trade creditors will be able to avail themselves of the breach of trust remedy and recovery from the contractor and its officer or directors or those in control of the contractor will be determined by the extent to which a contractor has arranged its business affairs.

If the contractor posted a labour and payment with the owner, the trades will be able to make claims under the payment bonds. The extent of any recovery by the trades will depend on the amount paid by the owner to the contractor and whether there is a "pay-when-paid" clause in the subcontract. The trades may not fully recover from the surety the amounts owed by the contractor.

If the project is not complete and the owner has required that the surety complete the contract under the surety's performance bond, the owner will make available to the surety the balance of the contract funds and have the surety complete the contract. If the balance of the contract funds is insufficient to complete the work, generally the surety will make available the shortfall required to complete the contract. If there is no performance bond, then the owner will retain any earned and unpaid amount (net of holdback) and use those funds along with the balance of the contract funds to complete the work.

c) Subcontractor defaults

Where the defaulting party is the trade, the suppliers to the insolvent trade are in the same position as outlined above where the defaulting party is the contractor.[25] In this scenario, the contractor will be liable to suppliers and sub-subcontractors of the trade for the holdback and

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[23] *Bellissimo Excavating Ltd. v Ding* (2004) 34 CLR (3d) 603 at para. 5, aff'd 2004 CanLII 33366 (Ont Sup Ct).
[24] *Trans Gas Ltd. v Mid-Plains Contractors Ltd.,* [1994] 3SCR 753 (SCC). Although the Canada Revenue Agency does exercise its super-priority to trust funds and holdback, it does so recognizing the impact that this will have on trades of the debtor. As a result, in many instances, the Canada Revenue Agency has accepted lesser amounts than it would otherwise be entitled to under its super-priority.
[25] See s. 23(3) of the *Construction Lien Act.*

earned and unpaid amounts subject to set-off. The expectation of the suppliers and sub-subcontractors of the insolvent trade is to be paid the holdback. The decisions in *Reliance Electric Ltd. v. G.N.S. Contractors Inc.*[26] and *James Dick Construction Ltd. v. Durham Board of Education*[27] stand for the proposition that where a subcontractor defaults and sub-subcontractors and suppliers register liens which the contractor vacates upon posting security into court, the contractor's liability is limited to holdback and any earned and unpaid amounts. However, the earned and unpaid amount held by the contractor would be subject to set-off rights of the contractor.

Just as in the scenario where the defaulting party is the contractor, the Canada Revenue Agency's super-priority would take precedence over all the liens of suppliers and sub-subcontractors leaving no amount for distribution to the suppliers.[28]

The suppliers and sub-subcontractors will also have available to them the breach of trust remedy, however recovery from the subcontractor and its officers and directors will again depend on any arrangements regarding the business affairs of these parties. In addition, if the trades posted labour and material payment bonds with the contractor, the suppliers will be entitled to make claims under the payment bonds.

d) Expectations

Having assessed the outcome of a default in the ordinary course, this may serve as a benchmark for the expectation of those involved in a construction project where a party is insolvent and has commenced insolvency proceedings. Generally, the recovery appears to be limited to holdback. This is consistent with the rationale behind the *Construction Lien Act:* "The holdback is often the only amount available to satisfy lien claims".[29] However, where a construction sector company has commenced insolvency proceedings, the expectation of its construction creditors appears to be that they are in some way entitled to more than they would normally receive or even expect in an ordinary default.

IV. Established Principles

a) The purpose of insolvency law is to avoid bankruptcy

In the recent decision *Ted Leroy Trucking [Century Services] Ltd., Re,* the Supreme Court of Canada reiterated the first legal principle to consider with respect to insolvency proceedings: the

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[26] *Reliance Electric Ltd. v G.N.S. Contractors Inc.* (1989), 35 CLR 310 (Ont SC, H Ct J).
[27] *James Dick Construction Ltd. v Durham Board of Education,* 1998 CarswellOnt 2928 (Ont Gen Div), aff'd (2000), 4 CLR (3d) 256 (Ont Div Ct).
[28] S. 224 of the *Income Tax Act*, RSC 1985, c. 1 (5th Supp.).
[29] Report of the Attorney General's Advisory Committee on the Draft Construction Lien Act, Letter of Transmittal to the Honourable R. Roy McMurtry, Q.C., Attorney General for Ontario, April 8, 1982.

purpose of insolvency law is to avoid multiple concurrent debt enforcement proceedings and to facilitate the debtor's negotiations with the creditors.[30]

> The purpose of the *CCAA* […] is to permit the debtor to continue to carry on business and, where possible, avoid the social and economic costs of liquidating its assets. Proposals to creditors under the *BIA* serve the same remedial purpose.[31]

In the *Century Services* decision, the Supreme Court of Canada also summarized its reflections on the differences and similarities between insolvency proceedings under the *BIA* and the *CCAA* and the interaction between the two statutes.

The *BIA* establishes a legal regime for the reorganization and the liquidation of the assets of any person, natural or legal, and is characterized by its rule-based approach to insolvency proceedings. There are two possible outcomes in a *BIA* proceeding:

a) After an initial court order is issued to stay all individual creditor actions against the debtor, a proposal is made to the creditors, it is accepted, a binding compromise is reached and bankruptcy is averted; or,
b) The proposal fails and the proceedings conclude with the liquidation of the assets, the distribution of the proceeds to the creditors in accordance with the statutory priority rules under the *BIA*, resulting in a bankruptcy.

Access to *CCAA* protection is more restrictive than the *BIA*, as it is only available to companies that owe $5 million or more in liabilities. The *CCAA* provides for the "broad and flexible authority to the supervising court to make the orders necessary to facilitate the reorganization of the debtor and achieve the *CCAA*'s objectives".[32] There are three possible outcomes in a *CCAA* proceeding:

a) the stay of all individual proceedings allows the debtor to restore solvency without reorganization;
b) the debtor's compromise is accepted by the creditors and the reorganized company emerges as a going concern; or
c) if the debtor's compromise is not accepted, the debtor or the creditors can seek liquidation under the *BIA* or place the debtor into receivership.

Both statutes offer a single collective proceeding model to prevent the inefficiency of numerous creditors individually exercising their remedies against the insolvent debtor. In addition, the stay of proceedings and the single forum place all creditors on an equal footing and facilitate negotiations between the insolvent company and its creditors.[33] The reflections of the Supreme

[30] [2010] 3 SCR 379 [*Century Services*] at paras12 to 24.
[31] *Ibid.* at para 14.
[32] *Ibid.* at para 19.
[33] *Ibid.* at para 22.

Court of Canada demonstrate the efficiency and orderliness that is sought in insolvency proceedings highlighting that in the insolvency of construction industry companies, something more may be necessary to ensure that the goals of efficiency and orderliness are attained. In addition, the summary provided by the Supreme Court of Canada also highlights that while the process between a *BIA* insolvency and *CCAA* insolvency may be different, the manner in which all creditors are to be treated should be the same.

b) Initial orders provide for a stay of all proceedings against the insolvent debtor

Section 11 of the *CCAA* confers a broad and flexible discretionary jurisdiction to the courts to make any order that will provide to a debtor the necessary conditions to attempt a reorganization while continuing to operate as a going concern in the meantime. This will afford the debtor the time to prepare a compromise for presentation to its creditors, all under the court's supervision.[34] Section 11.02 of the *CCAA* also confers the express and broad jurisdiction to the court to make certain orders, including an order to stay all existing proceedings or prohibit the commencement of any new proceedings against the debtor.[35] The orders made by Justice Morawetz in the Comstock proceeding, which are discussed in part V of this paper, are grounded in the *CCAA* principles, which Justice Deschamps restated for the majority in *Century Services* as follows:

> The general language of the *CCAA* should not be read as being restricted by the availability of more specific orders. However, the requirements of appropriateness, good faith, and due diligence are baseline considerations that a court should always bear in mind when exercising *CCAA* authority. Appropriateness under the *CCAA* is assessed by inquiring whether the order sought advances the policy objectives underlying the *CCAA*. The question is whether the order will usefully further efforts to achieve the remedial purpose of the *CCAA* – avoiding the social and economic losses resulting from liquidation or an insolvent company. I would add that appropriateness extends not only to the purpose of the order, but also to the means it employs. Courts should be mindful that chances for successful reorganizations are enhanced where participants achieve common ground and all stakeholders are treated as advantageously and fairly as the circumstances permit.[36]

Most construction lawyers take exception to the provisions in an initial Order that prohibit the commencement of any action or that stay an on-going action against the insolvent construction sector company. However, when viewed from the perspective of the objectives of a *CCAA* proceeding, to facilitate the reorganization of the debtor and to have all issues related to the insolvent debtor addressed in a single forum, the stay and the prohibition against commencing new actions against the debtor make sense. Furthermore, a stay allows for the claims of owners and other trade creditors to be addressed on a project-by-project basis, thereby increasing the

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[34] *Ibid.* at para 60.
[35] *Ibid.* at para 69.
[36] *Ibid.* at para 70.

efficiency and orderliness of the insolvency proceeding. In Ontario, this idea of having all claims related to a project addressed in a single forum at the same time is embodied in the *Construction Lien Act* at section 51:

> 51. The court, whether the action is being tried by a judge or on a reference by a master, a case management master or a person agreed on by the parties,
>
> (a) shall try the action, including any set-off, crossclaim, counterclaim and, subject to section 56, third party claim, and all questions that arise therein or that are necessary to be tried in order to dispose completely of the action and to adjust the rights and liabilities of the persons appearing before it or upon whom notice of trial has been served; and
>
> (b) shall take all accounts, make all inquiries, give all directions and do all things necessary to dispose finally of the action and all matters, questions and accounts arising therein or at the trial and to adjust the rights and liabilities of, and give all necessary relief to, all parties to the action.

The Ontario lien courts have a broad mandate to adjust the rights and liabilities of all persons appearing before the court. The insolvency proceeding of a construction sector company should do the same thing. So for example, where the owner developer has commenced insolvency proceedings, all those with an interest in the properties held by the owner developer should have their rights, and the liabilities of the debtor tried and adjusted at the same time in the same forum. Furthermore, the adjustment of rights and liabilities should occur on a project by project basis. Having the insolvency proceeding administered in this fashion should lead to an orderly and efficient administration of the insolvent company.

c) The stay of proceedings in the initial order may be lifted to allow the preservation and perfection of rights

Although the model order used in *CCAA* insolvency proceedings now permits the lifting of a stay in limited circumstances, the *CCAA* court has lifted the stay to permit a right or cause of action to be maintained. For example, during the Livent insolvency proceedings, Livent’s initial order stayed all existing actions and prohibited the commencement of any action against Livent. With lien rights on the eve of expiration, the lien claimants obtained an Order from Justice Ground that permitted them to preserve their liens, perfect their liens by issuing statements of claim, serve the statements of claim on Livent’s counsel and the monitor and thereafter stayed the lien actions.

More recently in the insolvency of Silver Streams Homes Inc. and related companies, Justice Putillo permitted the stay to be lifted to allow a Silver Stream creditor to commence a breach of trust action under the *Construction Lien Act* against Silver Steam and its officers and directors. Justice Putillo stated in her endorsement:

> In my view, the balance of convenience favours lifting the stay to permit both trust actions to be issued and served. I am also of the view that the defendants in the actions

> should file statement of defence. Thereafter the stay should resume until further order of the court. The Moving Parties should be permitted to commence their actions to avoid any limitation issues. Apart from costs to prepare defences, I see no prejudice to the defendants. I do not consider such costs to be prohibitive.[37]

The lifting of a stay to preserve a right or a cause of action is however different from the situation where a trade creditor attempts to lift the stay in order to obtain payment of its claim at an early stage. Generally the court will not allow this as it is not consistent with facilitating the debtor's reorganization and ongoing survival. In the *Century Services* case, the Supreme Court of Canada expressed this as follows: [38]

> The single proceeding model avoids the inefficiency and chaos that would attend insolvency if each creditor initiated proceedings to recover its debt. Grouping all possible actions against the debtor into a single proceeding controlled in a single forum facilitates negotiations with creditors because it places them all on an equal footing, rather than exposing them to the risk that a more aggressive creditor will realize its claims against the debtor's limited assets while the other creditors attempt to a compromise. With a view to achieving that purpose, both the CCAA and BIA allow a court to order all actions against a debtor to be stayed while a compromise is sought.

Avoiding the effects of an aggressive creditor realizing against the limited assets available is embodied in the Ontario lien legislation and is similar in nature to the effect of a stay in an insolvency proceeding. Aside from the class nature of a lien action, which requires all liens in respect of the same property to be tried at the same time and in the same forum, several provisions of the *Construction Lien Act* effectively provide for the stay of the distribution of the available funds pending the adjudication and outcome of all other lien claims in respect of the same project.[39] Once all liens have been determined and the priorities of the liens established, the available funds are then distributed.

d) The Model Initial Order

In British Columbia, a Practice Direction dated June 30, 2011 set out the standard form of the Model Initial Order to be used in *CCAA* proceedings in British Columbia.[40] The Practice Direction requires that the Model Initial *CCAA* Order be used unless the petitioner is seeking relief that differs from that provided in the Model Initial Order. Paragraphs 15 and 16 set out the broad stay of proceedings provisions applicable to the insolvent company. Paragraph 17 of the

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[37] *In The Matter of a Plan of Compromise or Arrangement of Silver Streams Homes Inc., Silver Streams Homes (Puccini) Inc., 2148993 Ontario Inc., 2148990 Ontario Inc., 2147681Ontario Inc. and 2147650 Ontario Inc.* (September 23, 2014), Toronto Court File No: 13-10362-00-CL (Ont Sup Ct).
[38] *Century Service*s, *supra* note 29 at para 22.
[39] See sections 62(6), 64, 65(4) and 80(1) of the *Construction Lien Act*.
[40] Supreme Court of British Columbia, PD – 29, effective June 30, 2011.

Model Initial Order sets out the exceptions to the general stay of proceedings, one of which exceptions relates to liens.

> [The stay does not] prevent the registration or filing of a lien or claim for lien or the commencement of a Proceeding to protect lien or other rights that might otherwise be barred or extinguished by the effluxion of time, provided that no further step shall be taken in respect of such lien, claim for lien or Proceeding except for service of the initiating documentation on the Petitioner." The explanatory notes that accompany the Model Initial Order indicate that "there is no harm in allowing these proceedings to be commenced provided no further steps are taken.[41]

The initial *CCAA* model Order in Alberta[42] at paragraph 14 provides for the broad stay and also sets out certain exceptions to the stay, one of which is the "registration of a lien". Paragraph 15 also permits the creditor to commence an action in order to comply with any statutory requirements in order to preserve the creditor's rights at law, but then provides that no steps be taken in that action and that notice be given to the monitor. This is a slightly different formulation to the Initial Model Order in use in British Columbia but with the same effect.

The notes explaining the Alberta model order indicate[43] that the purpose behind the formulation of paragraph 15 is to alleviate "the onus placed on a claimant to seek Court approval to file whatever documents are necessary to meet the deadline in question" and that "No further steps are permitted beyond the action necessitated to comply with the limitation, except in accordance with other provisions of the order." It is clear that the exception with respect to liens in the Alberta initial model order permits an efficient and orderly administration of the insolvent company and the construction creditors know that at a minimum they can preserve and perfect their lien security.

Ontario has also adopted the approach that makes for efficient and orderly administration of the estate of the debtor company. The model Order was revised as of January 21, 2014 and is available on the Ontario Court's web site with respect to *CCAA* proceedings. The model order at paragraph 15 provides as follows:

> **NO EXERCISE OF RIGHTS OR REMEDIES**
>
> **THIS COURT ORDERS** that during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing, collectively being "Persons" and each being a "Person") against or in respect of the Applicant or the Monitor, or affecting the Business or the Property, are hereby stayed and suspended except with the written consent of the Applicant and the Monitor, or leave of this Court, provided that nothing in this Order shall (i) empower

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[41] British Columbia Model Initial CCAA Order, Explanatory notes, Page 3, Paragraph 8.
[42] Court of the Queen's Bench, Alberta, revised December 2012.
[43] Alberta Template CCAA Initial Order Explanatory Notes, revised December 2012, page 4.

> the Applicant to carry on any business which the Applicant is not lawfully entitled to carry on, (ii) affect such investigations, actions, suits or proceedings by a regulatory body as are permitted by Section 11.1 of the CCAA, (iii) prevent the filing of any registration to preserve or perfect a security interest, or (iv) prevent the registration of a claim for lien.

In Comstock's insolvency proceeding, the initial Order obtained was varied from the initial model Order by the deletion of the fourth exception in paragraph 15 of the Order that related to the registration of liens.

V. Comstock's *CCAA* Proceeding

On June 28, 2013, Comstock and its related companies filed a Notice of Intention to Make a Proposal under section 50.4 of the *BIA* with PricewaterhouseCoopers ("PwC") appointed as trustee. This was followed by the July 2, 2013 Order that appointed PwC as interim receiver of Comstock under section 47.1 of the BIA for the limited purpose of borrowing funds which were immediately required to permit the business operations of Comstock to continue. On July 9, 2013, Comstock obtained an order that, in part, provided, that the *BIA* proceedings was continued under the *CCAA* and that PwC was appointed monitor of Comstock.

The initial Order in the Comstock *CCAA* proceeding included the following stay provisions at paragraph 21 and 22:

> **NO PROCEEDINGS AGAINST THE APPLICANTS OR THE PROPERTY**
>
> **THIS COURT ORDERS** that, except as provided in paragraph 17 herein, until and including Thursday, August 8, 2013, or such later date as this Court may order (the "Stay Period"), no proceeding or enforcement process in any court or tribunal (each, a "Proceeding") shall be commenced or continued against or in respect of the Applicants or the Monitor, or affecting the Business or the Property, except with the written consent of the Applicants and the Monitor, or with leave of this Court, and any and all Proceedings currently under way against or in respect of the Applicants or affecting the Business or the Property are hereby stayed and suspended pending further Order of this Court.
>
> **NO EXERCISE OF RIGHTS OR REMEDIES**
>
> **THIS COURT ORDERS** that, except as provided in paragraph 17 herein, during the Stay Period, all rights and remedies of any individual, firm, corporation, governmental body or agency, or any other entities (all of the foregoing collectively being "Persons" and each being a "Person") against or in respect of the Applicants or the Monitor, or affecting the Business or the Property, are hereby stayed and suspended except with the written consent of the Applicants and the Monitor, or leave of this Court, provided that nothing in this Order shall (i) empower the Applicants to carry on any business which the Applicants is not lawfully entitled to carry on, (ii) affect such investigations,

> actions, suits or proceedings by a regulatory body as are permitted by Section 11.1 of the CCAA, or **(iii) prevent the filing of any registration to preserve or perfect a security interest.** [*Emphasis added*]

The initial Order in Comstock did not follow the model initial Order then in use in Ontario with respect to the stay of proceedings. Absent from the Comstock initial Order was the usual exception to the stay that permitted suppliers of materials and services to preserve and perfect liens and thereafter stay the lien proceedings.

Shortly after the initial Order was issued, a couple of liens were preserved on one of Comstock's projects. The lien claimants were required to explain their conduct that seemingly contravened paragraph 21 of Justice Morawetz's July 9, 2013 Order. Aside from not being aware of the Order, the lien claimants argued that the Order permitted the perfection of "security interests" and as such, the preservation of the lien security interest was consistent with the Order.[44] The airing of this issue left unanswered the question as to why a creditor with an unperfected security interest was permitted to perfect that security interest while the preservation and perfection of a lien was not included as an exception to the stay. Either the stay applied to all security interests or it did not. Furthermore, the Comstock initial Order did not treat all creditors of Comstock fairly and equally. The fact that trades were required to attend at court and explain their conduct highlights the inefficiency of the initial Comstock Order. Also, the trades were left guessing as to whether the stay applied to them. This level of uncertainty would have meant that each trade would have had to bring an application to lift the stay to permit the preservation and perfection of their lien, a wholly inefficient process. The monitor no doubt saw a need to avoid any stoppage of the flow of funds on the projects that Comstock was still completing and rather than looking for a solution, merely dropped the preservation and perfection of liens from the exception in the model initial Order..

This highlights a central concern in Comstock's insolvency, namely the completion of the projects and contracts or subcontracts without stopping the flow of funds on those projects. As discussed above, while the insolvency court is likely to lift a stay to permit a creditor to preserve its rights, the registration of liens would effectively stop the flow of funds on the project, thereby increasing the likelihood that Comstock would not be able to carry on and no doubt resulting in the bankruptcy of Comstock. Comstock's monitor expressed the concern and resulting issues as follows:[45]

> 34. The issue of liens on Comstock projects has been and continues to be a major concern for the Company, especially as it relates to the Ongoing Contracts and Reviewable Contracts. Notices of liens or the actual placement of liens

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[44] See *P & D Holdings Ltd. v Alta Surety Co.* (1996), 29 CLR (2d) 60 (Ont CA), which stands for the proposition that a lien claim is a right to claim security in a property or a fund. The premises improved by the claimant's work or materials becomes a term of security for payment by the owner to the claimant.

[45] Third Report to Court of Comstock's Monitor, August 6, 2013.

essentially stops the flow of funds on projects which puts Comstock's ability to continue as a going-concern at risk. In certain situations customers have bonded off these liens; however, even in these situations, the customer has not remitted payment after such liens were bonded off, further holding up the release of funds.

35. The risk of non-payment or stalled payments creates a significant risk for the Company as it relates to is[sic] borrowings under the DIP Credit Facility. The Company only has a $7.8M DIP Credit Facility, and the Company continues to make payments to employees, both unionized and salary, in order to continue to meet its obligations on Ongoing Contracts and Reviewable Contracts and any significant delay in payment, or set-off for liens exposes the Company to certain short-term liquidity risks and its ability to manage its DIP Credit Facility during these CCAA proceedings. In certain situations, the Company may have to place its own liens on projects for non-payment of pre-filing accounts and/or services provided post-filing.

The expressed concern of Comstock's Monitor related to delays in payments or the set-off for liens is a real concern. When an owner receives a written notice of lien from contractor or subcontractor, the *Construction Lien Act* requires the owner to retain the value of the lien in addition to the statutory holdback.[46] As the flow of funds becomes a trickle, there is greater certainty that other trades will register liens, eventually drying up the flow of funds entirely. Although the flow of funds may resume where the liens are vacated upon the posting of security, the reality is that the insolvent company likely does not have the means to post security, particularly as its surety will refuse to issue lien bonds and its bank (likely already a creditor) will not provide any letters of credit to be paid into court to vacate the registration of the claims for lien.

A solution was required to allow the flow of funds unabated on on-going projects while addressing the preservation and perfection of lien rights, all the while permitting Comstock to continue its business operations and the completion of the projects. In Comstock's case, the solution was two-fold. First the monitor obtained the Amended and Restated Initial Order and second, the monitor obtained the Lien Regularization Order. To avoid any ambiguity regarding the stay, the Amended and Restated Initial Order made it clear that the preservation and perfection of liens was prohibited:

NO REGISTRATION OF LIENS

25. THIS COURT ORDERS AND DECLARES that no Person shall be permitted to preserve or perfect a lien under the *Construction Lien Act*, R.S.O. 1990, C.30, as amended (the "**Ontario CLA**"), the *Builders' Liens Act*, C.C.S.M. c. B-91 (the "**Manitoba BLA**"), the *Builders' Lien Act*, R.S.A. 2000, c. B-7 (the "**Alberta BLA**"), or the *Builders Lien Act*, S.B.C. 1997, C 45 (the "**B.C. BLA**"), including without restricting the generality of the foregoing, (a) registering a Claim for Lien

[46] S. 24(2) of the *Construction Lien Act.*

> under s. 34(1)(a) of the Ontario CLA, the Manitoba BLA, the Alberta BLA or s. 15 or s. 18 of the B.C. BLA with respect to any lands to which the Applicants have supplied services or materials, (b) registering a Certificate of Action under s. 36 of the Ontario CLA, the Manitoba BLA, the Alberta BLA, or commencing proceedings pursuant to section 26 of the B.C. BLA, with respect to any lands to which the Applicants have supplied services and materials; and (c) serving a Claim for Lien under s. 34(1)(b) of the Ontario CLA, the Manitoba BLA, the Alberta BLA, or delivering a Notice of Lien under s. 24(2) of the Ontario CLA, with respect to any project(s) to which any of the Applicants is a contracting party and/or is supplying goods and/or services except with the written consent of the Applicants and the Monitor, or with leave of this Court. This paragraph does not apply in the event the Comstock Group seeks to commence proceedings under the Ontario CLA, the Manitoba BLA, the Alberta BLA, or the B.C. BLA, or deliver a Notice of Lien, register a Claim for Lien, or register a Certificate of Action in favour of the Comstock Group or any one of the entities comprising the Comstock Group.

Second, on August 7, 2013, the monitor obtained the Lien Regularization Order. The Lien Regularization Order had several aspects to it. First, in the place of liens, the Order created a court ordered charge. Instead of the lien claimants being required to register a claim for lien, they were required to give notice to the monitor, the monitor's counsel and Comstock of their lien and lien claimant would have a court ordered charge as if they had preserved a lien by registration. Second, owners were protected for the payments they made in accordance with the Order. Third, anyone with an interest in the property and any payor above Comstock was entitled to challenge the timelines and quantum of the lien. Fourth, all liens that were not previously vacated upon the posting of security were vacated from title to the various projects and given a court ordered charge. Finally, the Order did not affect the rights of any person with respect to their trust rights under the construction and builders' lien legislation and did not affect any rights under the labour and material payment bonds or performance bonds or the right to bring a claim for damages or delay except that consent of the Monitor or leave of the Court was required to commence or continue these types of claims.

In summary, the steps taken by the Monitor prohibited the preservation and perfection of lien rights under construction and builders' lien legislation thereby effectively doing away with the lien legislation of four provinces. Then the Monitor created a court ordered charge that embodied the lien remedy. These steps were criticised at the time, however, on reflection the Lien Regularization Order was an elegant solution. It allowed for the flow of funds on Comstock's projects into the hands of the Monitor while recognizing liens of trades and suppliers of Comstock as if their lien rights had been preserved and perfected under the

applicable construction and builders' lien legislation. The Monitor expressed the rationalization for the Lien Regularization Order in the following terms:[47]

> 37. Given the foregoing, the Monitor understands that the Company is seeking a further order designed to address these issues in a global fashion (the "Lien Regularization Process"). Furthermore, the Lien Regularization Process will afford appropriate protection to creditors that their lien rights are not jeopardized.
>
> 38. The Lien Regularization Process entails, in summary, the following:
>
> i. pre and post lien registrations that have already been bonded off will remain unaffected;
> ii. pre and post lien registrations that have not been bonded off will be vacated;
> iii. in return, such lien claimants will be provided with a court ordered charge (the "Lien Charge") which will operate in the same manner as if such lien claimant in fact did preserve and perfect its lien rights under the relevant provincial legislation with respect to the basic holdback obligations provided for under such legislation;
> iv. payers above Comstock in the construction pyramid will be able to continue to make payments as if such liens were not registered or notice of same not given but are also restrained from setting off any amounts against the basic holdback amount owing by them and, in return, protected from liability for making such payments;
> v. lien claimants otherwise having lien rights under provincial law will provide a notice to the Monitor which notice will give effect to the Lien Charge in that claimant's favour for the amount claimed, subject to review and final determination by the Court if not agreed to with the Monitor;
> vi. final payouts on completed projects will be consistent with what would have been otherwise occurred under the relevant provincial legislation pertaining to such lien claims; and
> vii. upon a default under the DIP Credit Facility, the repayment of any amount owing to the DIP Lender shall not be made without a further order of this Court which order shall determine the appropriate source and allocation of funds to be used to effect such repayment.
>
> 39. The Monitor supports the Lien Regularization Process for all of the above reasons as this process gives Comstock and its creditors and customers' appropriate protection to ensure there is a flow of funds from customers and potential lien claimants' rights are not jeopardized.

It could be argued that doing away with validly enacted Provincial lien legislation is unconstitutional. It could also be argued that substituting validly enacted lien legislation with the creation of a lien charge by way of a court order is outside the broad discretion afforded a court in a CCAA proceeding. However, the result in the circumstances is practical for a number of reasons. First, it protects the rights of lien claimants by recognizing their liens; second, it permits the continued flow of funds so that projects may be completed; and third, it provides a process for the lien claimants to recover what they would have recovered had their lien rights been preserved and perfected under applicable lien legislation. In addition, the Lien

[47] Third Report to Court of Comstock's Monitor, August 6, 2013, page 16-17.

Regularization Order left the adjustment of the rights and liabilities of the parties to be determined at a later date, in the event that the parties could not come to a resolution. The process can be perceived as an orderly and efficient administration of the insolvent estate without the necessity of each lien claimant obtaining the consent of the insolvent company and the monitor, or if necessary an order of the Court, to lift the stay to permit the preservation and perfection of lien rights. In addition, the process permitted Comstock to continue its operations in order to complete projects while recognizing the rights of its creditors, all the while maintaining the flow of funds on the projects. This creative solution, although initially concerning to lien claimants insofar as it arose from an initial order that appeared to erode their statutory rights, appears to be consistent with the reflections by the Supreme Court of Canada on *CCAA* proceedings set out in *Century Services*:[48]

> When large companies encounter difficulty, reorganizations become increasingly complex. *CCAA* courts have been called upon to innovate accordingly in exercising their jurisdiction beyond merely staying proceedings against the debtor to allow room for reorganization. They have been asked to sanction measures for which there is no explicit authority in the *CCAA*. Without exhaustively cataloguing the various measures taken under the authority of the *CCAA*, it is useful to refer briefly to a few examples to illustrate the flexibility the statute affords supervising courts.

VI. Trust Claims and Insolvency Proceedings

Canadian Courts have repeatedly affirmed that provincial statutory deemed trusts do not defeat a secured party's rights to funds in *CCAA* or *BIA* insolvency proceedings. This principle has been recently reaffirmed specifically with respect to deemed trusts in construction and builders' lien legislation in two recent decisions, *Royal Bank v. Atlas Block*[49] in Ontario and *Iona v. Guarantee Company of North America*,[50] in Alberta. The results in *Atlas* and *Iona* are consistent with the prior authorities on this issue and represent a call to Provincial and Federal legislators that if the trust remedy is to be of any effect in insolvency proceedings, an amendment is required to the legislation.

In the 1962 decision *John M.M. Troup Ltd. v. Royal Bank,*[51] the Supreme Court of Canada had held that provincial lien legislation is competent legislation that does not conflict with federal bankruptcy and insolvency laws:

> While it is true that the rights given by s. 3(1) [of the *Mechanics' Lien Act,* RSO 1950, c.227, as amended by 1952, c.54, s.1], do not depend on the right to a lien, it is competent provincial legislation in relation to the obligations of a building contractor

[48] *Century Services*, *supra* note 29 at para 61. See also paras 62 to 68.
[49] *Royal Bank v Atlas Block* Co. (2014), ONSC 3062, (Ont Sup Ct) [*Atlas*].
[50] *Iona Contractors Ltd. (Receiver of) v Guarantee Co. of North America* (2014), ABQB 347, (Alta QB) [*Iona*].
[51] *John M.M. Troup Ltd. v Royal Bank*, [1962] SCR 487 (SCC) [*Troup*].

> […]. If there is any force in the submission, it must be because competent provincial legislation comes into conflict with and to that extent is overborne or rendered inapplicable by valid federal legislation. It is suggested that the legislation is in conflict with federal legislation on banking and bankruptcy but in my opinion the conflict does not exist in either field. […] As to bankruptcy, the creation of the trust by s. 3(1) does affect the amount of property divisible among the creditors but so does any other trust validly created.[52]

Just over twenty years later, the Supreme Court of Canada considered the effect of s. 67(1)[53] of the *BIA* on provincial statutory trusts in the decision *British Columbia v. Henfrey Samson Belair Ltd.[54]* The Supreme Court of Canada held that the provisions of s. 67(1) of the *BIA* should not apply to trusts lacking the common law attributes of trusts.[55] A statutory deemed trust may still meet the requirements for a trust under the principles of trust law, unless and until the trust property is commingled with other funds, at which point it can no longer be traced.[56] The Supreme Court of Canada also noted that interpreting s. 67 of the *BIA* otherwise in relation to provincial statutory trusts would "be to permit the provinces to create their own priorities under the Bankruptcy Act and to invite a differential scheme of distribution on bankruptcy from province to province".[57]

In *Atlas,* the Atlas Block Co. group of companies ("Atlas") operated out of three Ontario locations and manufactured concrete building and landscaping products, for example paving stones, concrete veneers and concrete blocks. Atlas' products were sold directly to industrial and commercial contractors, and to retailers through various distribution channels. Holcim (Canada) Inc. ("Holcim") supplied Atlas with cement powder, which it delivered in bulk for manufacturing purposes and in bags for retail and construction projects. KPMG was appointed as receiver of all of Atlas' assets, undertakings and property, after which some of Atlas' entities filed assignments in bankruptcy and finally, the Court approved the sale of Atlas' assets, including inventory.

The Receiver brought a motion for directions, asking the court to determine whether Holcim had a trust claim under section 8 of the *Construction Lien Act* over revenue received from Atlas' construction customers. Justice Penny held that although Holcim may have had a trust claim, such trust claim did not survive Atlas' bankruptcy and the Receiver had no obligation to segregate the trust funds for the benefit of Holcim.

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[52] *Ibid.* at paras 10 and 11.
[53] Section 67(1) of the BIA currently provides, in part: The property of a bankrupt divisible among his creditors shall not comprise (a) property held by the bankrupt in trust for any other person.
[54] *British Columbia v Henfrey Samson Belair Ltd.,* [1989] 2 SCR 24 (SCC) [*Henfrey Samson*].
[55] *Ibid.* at paras 38, 44.
[56] *Ibid.* at paras 45 and 46.
[57] *Ibid.* at para 42.

Justice Penny agreed with the Receiver's argument that even if the *Construction Lien Act,* which is Provincial legislation, did entitle Holcim to the benefit of a deemed or statutory trust, the trust funds became part of the estate property divisible among the creditors of the bankrupt as required by the *BIA*. Section 67(1) of the *BIA* excludes "any property held by the bankrupt in trust for any other person" from the divisible estate property. Section 67(1) only applies to trusts that have all the attributes of a valid trust at common law and does not extend to assets subject to a deemed trust created by Provincial legislation. A valid common law trust requires three certainties: intention, subject matter and object. The trust alleged by Holcim lacked the certainty of subject matter because Atlas did not segregate the payments received from construction projects and instead commingled them with other funds. The Court held that there is no apparent reason why a deemed trust under the *Construction Lien Act* should be treated any differently from any other Provincial statutory deemed trust for the purpose of paragraph 67(1) of the *BIA*.

In *Iona,* Iona Contractors Ltd. ("Iona") had entered into a contract with the Calgary Airport Authority (the "Airport") to perform work on the Airport's North airfield. When the contract was substantially performed, the Airport received notice that some of Iona's subcontractors remained unpaid. As a result the Airport withheld any further payment to Iona. Within weeks, Iona applied for CCAA protection and after several months was assigned into bankruptcy. The Airport retained almost $1 million in holdback on a $15 million contract. The surety who had issued a labour and material payment bond for the project ("GCNA") made payments of $1.4 million to Iona's subcontractors.

GCNA claimed entitlement to the holdback as subrogee to the Airport who was obligated to pay Iona's subcontractors. GCNA argued that if the holdback was due to Iona, the holdback funds were held in trust for the subcontractors pursuant to section 22 of the *Alberta Builders' Lien Act.* The trustee in bankruptcy argued that the holdback was due to Iona for work performed, and was therefore part of the bankrupt's estate for distribution to Iona's secured creditor, Alberta Treasury Branches.

The Court held that the trust created by section 22 of the Alberta *Builders' Lien Act* was not exempt under s. 67(1) (a) of the *BIA* and that, since GCNA had not made an argument for a valid common law trust, the holdback due and owing to Iona would be distributed to Iona's secured creditor, in accordance with the normal distribution directions under section 136 of the *BIA*.

GCNA's argument relied on the *Troup*[58] decision. Justice Eidsvik in *Iona* found that she could not follow the *Troup* decision because it had "in effect been overruled by the Supreme Court of Canada in *Husky* and *Henfrey Samson*" on two principles: provinces cannot create priorities or change the scheme of distribution in a bankruptcy because of the principle of paramountcy and only common law trusts are exempt under s. 67(1)(a) of the *BIA*.

[58] *Supra* note 50.

The courts have made it clear that as the trust provisions in the construction and builders' lien legislation do not have all the elements of a common law trust, and therefore the remedy is legislative. However, to date, both Provincial and Federal legislators have failed to address this issue by passing legislation to address trust funds on construction projects.

Canada is stuck debating paramountcy and priorities. The trust provisions in construction and builders' lien legislation has been sterilized and relegated to the status of deemed trusts. It appears that the legislators will not take the initiative and address the issue and therefore the private sector should step in and find a solution. The solution may be found in other jurisdictions that are slowly moving to a trust model to protect trades from the insolvency of construction companies.[59]

The position in Canada can be contrasted with that in Australia. As far back as 1999, New South Wales had legislation that addressed prompt payment.[60] However a study by Kingsway Financial covering the period July 1, 2009 to June 30, 2010 regarding the insolvency of the construction sector in Australia had the following findings:[61]

a) 8,054 insolvencies were reported during the review period;
b) 1,862 construction sector insolvencies during the review period;
c) 23% of all insolvencies are in the construction sector;
d) 54% of Australian construction sector insolvencies occurred in the state of New South Wales;
e) AUS $2.64 billion is the estimated amount of money lost by creditors annually in construction related insolvencies; and
f) Zero dollars is the likely return to unsecured creditors in the event of a bankruptcy.

The Kingsway assessment noted that the data covered a period of significant government intervention in the Australian economy with the $42 billion National Stimulus Package, a key component of which included the Building the Education Revolution (BER) program.[62] The BER program was intended to provide rapid construction and renovation of infrastructure for Australian schools including AUS $14.05 billion for new and renovated gyms and assembly areas, libraries, classrooms and AUS $1.3 billion for new and renovated covered outdoor learning areas, shade structures and sporting facilities. The largest recipient was the New South

[59] See for example the H&V News website that has started a petition to establish a legal framework whereby all retention money on a project is held in trust.
[60] *Building and Construction Industry Security of Payment Act* 2009 [SOPA].
[61] "Corporate Insolvency in the Australian Construction Sector: Key findings from ASIC insolvency data 2010-2011", Kingsway Financial Assessments Pty Ltd., released February 7, 2012. Construction sector insolvencies have become so endemic in Australia such that on December 4, 2014, the Senate referred an inquiry into solvency in the Australian construction industry to the Senate Economic References Committee for a report by November 11, 2015 (Government of Australia, Parliamentary Business Committees, Senate).
[62] *Ibid*, page 3.

Wales government which received some AUS $3.5 billion for capital works in primary, secondary and central government schools in the state.[63]

However, despite this economic activity in the construction sector, the Kingsway assessment noted that there is a persistent high level of insolvencies in the Australian construction sector. As a result the New South Wales government launched the Collins Inquiry into construction industry insolvencies which made a number of recommendations. Most notably, one of the recommendations of the Collins Inquiry to address insolvencies in the construction sector was the imposition of a trust similar to the Ontario framework under Part II of the *Construction Lien Act*. The sixth recommendation of the Collins Inquiry provides as follows:

> Recommendation 6: The Construction Trust
>
> Any payment by a principal to a head contractor or by a head contractor to a subcontractor on account of, or in respect of, any work done or materials supplied by the head contractor, any subcontractor, sub-subcontractor or supplier whether as a result of a favourable adjudication under SOPA or not, shall be made and treated in the following way:
>
> - any cheque drawn upon a bank account in favour of the head contractor in respect of such work shall be held on trust for the head contractor, subcontractor, sub-subcontractor and supplier; and
> - the proceeds of any such cheques when banked will be held upon the same trust for the head contractor, subcontractor, sub-subcontractor and supplier;
> - where moneys are paid by electronic transfer they will be deemed to be held in trust by the head contractor the instant they are received by electronic transfer from the principal.
>
> The statutory construction trust requirement should apply to all building projects valued at $1,000,000 or more.
>
> The statutory construction trust will be established for the purposes of paying the subcontractors and suppliers. [64]

The commentary to Recommendation 6 further indicates that the recommended construction trust is to include the formal segregation of the trust funds:

> The first important characteristic of this trust is that the moneys are not at any time deposited into a bank account owned and operated by the head contractor. There is no point at which the funds may be "scooped" by the bank, nor is there any physical

[63] Report 35 – September 2010, Parliament, Legislative Council, General Purpose Standing Committee No. 2 [Sydney N.S.W.], *Inquiry into the Building the Education Revolution program*.
[64] Bruce Collins, QC, *Final Report, Independent Inquiry Into Construction Industry Insolvency in NSW*, November 2012, page 355.

> payment outside the trust account by a head contractor to a subcontractor which might attract the unfavourable attention of the rules concerning preferences. […] The objective is to pay the trust moneys out as quickly as possible to those who are entitled to them.[65]

The eighth recommendation incorporated section 8(2) of the *Construction Lien Act* requiring the trustee of the trust fund not to appropriate or convert the trust fund to a use inconsistent with the trust or for the trustee's own use until all those owed money by the trustee (contractor or subcontractor) are paid all amounts owed to them. The commentary to the eighth recommendation reads in part as follows:

> Section 8(2) of the Ontario Act makes it plain, as does section 8(1), that the trust applies to suppliers as well as to contractors and subcontractors. That is as it should be. [66]

It is worth noting that the Collins Inquiry is not the first time that the Australian government flirted with a segregated trust account for a construction project. The report of the Law Reform Commission of Western Australia recommended that a trust scheme be established statutorily and that "a trustee, including an owner building his own home, should be required to keep trust funds in a trust account, separate from its general banking account."[67] In addition, the Report also recommended the following in relation to an insolvent company:

> Where the trust fund is insolvent so that there are insufficient funds to satisfy the claims of all beneficiaries of the trust, the trust funds should be distributed amongst the trust's beneficiaries on a pro rata basis.[68]

The response of the New South Wales Government has been to introduce legislation that would require retention (holdback) funds to be placed into a segregated trust account. The Government was however not prepared to introduce the concept of the trust more broadly but would try project specific bank accounts for certain government projects.[69]

In the UK, many believe that the government will not change the status quo and elevate retention funds on a project to trust funds because that would defeat secured creditors and therefore the

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[65] *Idem.*

[66] *Ibid.,* page 356.

[67] Recommendation 11, page 106, The Law Reform Commission of Western Australia, Project No. 82, *Financial Protection in the Building and Construction Industry*, March 1998.

[68] Recommendation 19, page 108, The Law Reform Commission of Western Australia, Project No. 82, *Financial Protection in the Building and Construction Industry*, March 1998.

[69] Response of the New South Wales Government to the Collins Inquiry, http://www.finance.nsw.gov.au/sites/default/files/pdfs/20130418-collins-response-summary-for-web.pdf ; see also Finance and Services, New South Wales Government, *Consultation Paper, A Statutory Retention Trust Fund for the Building and Construction Industry*, November 2013 and New South Wales Parliamentary Research Service, e-brief 04/2013, *Construction Industry in NSW: Background to the Insolvency Inquiry*, John Wilkinson, May 2013..

legislation would not pass.[70] However, in the United Kingdom, government agencies have undertaken a pilot project to introduce project bank accounts (PBA). In its 2012 briefing document, the UK Government sets out that "Government Construction Board members have committed, over the next three years, to deliver £4bn worth of construction projects using PBAs."[71] The briefing document identified the benefits of a PBA as follows:[72]

> Simple though the concept is, PBAs directly deliver against a range of the aims of the Government Construction Strategy. By addressing unfair payment practices, benefits will accrue to the whole supply team, by ensuring transparency of and certainty of payment. In particular, for the SMEs down the supply chain PBAs will protect their often very fine margins, obviate the need for unnecessary borrowing and can lead to a much more balanced trade environment, hence supporting growth. Cost savings accrue from supply chain members not having to chase payment or have to finance lengthy credit periods. PBAs eliminate payment disputes and the costs associated with them (which ultimately feed back into costs for the client). They also help the supply chain concentrate on the job in hand and reinforce or facilitate team working, increased trust leads to greater collaboration, which in turn incentivises innovation.

Although these benefits are laudable, conspicuously absent is that a PBA would protect trades from the insolvency of a contractor. However, in the UK Government's guide to implementing PBAs, the guide states that a PBA "is linked to a Trust Deed, and provides insolvency protection for the supply chain."[73] The Northern Ireland guidance note on PBAs expressed the same benefit: "Insolvency of a Main Contractor often leads to a domino effect in the supply chain where, upon entering administration, its Subcontractors become exposed to the risk of insolvency."[74] The Northern Ireland guidance note also provides the following under Frequently Asked Questions:

> In the event of the insolvency of a Main Contractor can monies be removed from the PBA?
>
> In the event of insolvency of a Main Contractor, the Main Contractor cannot remove any monies from the PBA except those authorised to be paid to it by the PM. An administrator, receiver or liquidator of a Main Contractor may be able to delay payment of monies within the PBA to Subcontractors but will not be able to remove such monies.

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[70] See *Would retention trust funds work?* 22 March 2013, Building.co.uk.

[71] UK Government Cabinet Office, *Government Construction, Project Bank Accounts – Briefing Document*, 10th February 2012.

[72] *Ibid*.

[73] UK Government Cabinet Office, *Government Construction, A Guide to the implementation of Project Bank Accounts (PBAs) in construction for government clients*, 3 July 2012.

[74] Department of Finance and Personnel, Northern Ireland, Procurement Guidance Note PGN 03/14, *Construction Works Procurement: Project Bank Accounts (Pilot)*, issued 30 July 2014, at page 4.

A PBA is described as a "ring fenced" bank account from which payments are made by an owner to its contractor and then from the contractor to its trades. The significance of the PBA is that it has trust status and that its beneficiaries are the contractor and the subscribing trades and suppliers. A PBA is established by a series of agreements, or trust deeds. In the model in Northern Ireland, the owner and the contractor jointly make the request to open the PBA, execute a trust deed related to the account, provide the sample authorized signatures to the bank and the owner, contractor and trades or suppliers execute a "Joining Deed".[75] The model in the guidance notes for Northern Ireland suggests that a separate bank account will be opened for the project. Under the UK model, there are similar trust deeds executed by the parties, however the briefing document indicates that it is not necessary to open a separate bank account for the PBA. However, the failure to open up a separate PBA for each project may lead to arguments that it is not a trust due to the commingling with funds from other projects that may be, or may not be, subject to other PBA agreements. The UK model also permits a Dual Authority account where the owner and the contractor are the trustees or a Single Authority account where only the contractor is the trustee. Whether a Dual Authority or Single Authority account is used, it is not intended that the protection offered in terms of the security of the funds be altered in any way.

If owners started to demand the use of PBAs in Canada, with the use of trust deeds, the insolvency of contractors may be nothing more than an inconvenience. As at the date of the insolvency, the owner could value the work, pay any additional amount owed for the work to the date of insolvency into the PBA and have the trades and suppliers paid the amounts owing to them from the PBA. This would avert the registration of liens by the trades and suppliers, or at the very least minimize it. The owner would be holding onto the balance of the contract funds and use these funds to complete the project with either a new contractor or the insolvent contractor. If the owner proceeded to complete the work with the insolvent contractor, the monitor or the trustee would be required to sign the trust deed for the PBA, and the project could continue. Simply put, issues of priority to the funds vanish as the funds will be held in a trust account that meets the elements of a common law trust.

VII. Alternative Approach

The Comstock Lien Regularization Order was a good start to enabling the insolvencies of construction industry companies to be administered in an orderly and efficient manner. The Lien Regularization Order should be obtained simultaneously with Initial Orders. In addition, when a construction sector company choses to use the *BIA* procedure for its insolvency rather than the *CCAA* procedure, the insolvent company should be required to obtain a Lien

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[75] See Department of Finance and Personnel, Northern Ireland, Procurement Guidance Note PGN 03/14, *Construction Works Procurement: Project Bank Accounts (Pilot)*, *The Suite of Forms for Central Government Projects (Annex C)*, issued 30 July 2014, at page 4.

Regularization Order contemporaneously with its filing. This puts all creditors on the same footing, irrespective of the statute used to govern the insolvency proceeding.

It may be also argued that the Lien Regularization Order in Comstock did not go far enough. For example, while the Order permitted those with trust claims or labour and material payment bond claims or delay claims to proceed or continue with those types of claims, it did so only after the claimant obtained the consent of the Monitor or leave of the Court. This is not a very efficient process as each claimant would be required to write to the Monitor and ask for the Monitor's consent. If the consent is not forthcoming, the claimant would have to bring an application to obtain leave of the Court.

Consequently, trust claimants should be required to give notice of their trust claims to the Monitor and the insolvent company. Labour and material payment bond claimants should be required to give notice of their payment bond claims to the owner, the Monitor, the insolvent company and the surety. These claims can then be determined in the insolvency proceeding on a project by project basis. On a rolling basis then, the Monitor, the insolvent company and the surety can address the lien and trust claims on a project by project basis. As was provided in the Comstock Lien Regularization Order, at first instance the parties would attempt a resolution of the claims and if one could not be achieved, the matter could be returned to the insolvency court or be referred to, for example, the Master's Lien Court in Toronto, or to a Claims Officer appointed by the Court. All parties, including all secured creditors, with an interest in the funds related to a project can then have issues related to entitlement to the funds and the various claims determined. It can be argued that such a model is efficient as it seeks to address all the varied legal rights and fragmented interests of the parties involved in a construction sector company insolvency. It also addresses the Supreme Court of Canada's concern regarding aggressive creditors while permitting the insolvent company the opportunity to reorganize and avoid liquidation.

VIII. Conclusion

Insolvencies in the construction sector have increased in the last few years as compared to all insolvencies in Canada. As a result a model for the efficient and orderly administration of the insolvency proceedings is required, particularly in view of the varied legal rights and fragmented interests found on each construction project. The Comstock Lien Regularization Order was a good start to achieving a level of orderliness and efficiency to address these varied legal rights. Such an Order, however, needs to go further and permit all claims of all parties on a project to be addressed in a single forum. The priority disputes in insolvency proceedings to the funds in the hands of the insolvent contractor can be relegated to a memory with the use of project bank accounts where a trust that satisfies the elements of a common law trust is established for each project bank account. As a result of the failure to act by the legislatures, the push for the project bank account will undoubtedly have to come from the private sector.