

CONSTRUCTION LAW LETTER

Volume 31 • Number 6

July/August 2015

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PROJECT BANK ACCOUNTS: THEIR TIME HAS COME

Introduction

Despite the robust construction activity in Canada, insolvencies of owners and construction companies are at a pace significantly higher than ten years ago. Between 2009 and 2013, the construction sector as a value of the Canadian economy grew by 18 per cent. However, over the same period, the number of proposals in the construction sector increased to 16.8 per cent. These figures exclude cases where the court appointed a receiver or where a receiver was privately appointed. The data from the Office of the Superintendent of Bankruptcy suggests that as the construction sector grew, there was an increase in the number of proposals in the construction sector as compared to all insolvencies in Canada.

Secured creditors and contractors and their trades are chasing the same dollars. Canadian courts, in two recent decisions—*Royal Bank v. Atlas Block* in Ontario and *Iona Contractors Ltd. v. Guarantee Company of North America* in Alberta—have affirmed that the trusts in builders' and construction lien legislation do not have all the elements of a common law trust and are therefore deemed trusts that do not defeat a secured party's rights to funds in *Companies' Creditors Arrangement Act* or *Bankruptcy and Insolvency Act* proceedings. Therefore, if the construction

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CONSTRUCTION LAW LETTER

Construction Law Letter is published six times a year by LexisNexis Canada Inc., 123 Commerce Valley Drive East, Suite 700, Markham, Ont., L3T 7W8, and is available by subscription only.

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ISBN 0-433-40930-4 **ISSN 433409304**

ISBN 0-433-44380-4 (Print & PDF)

ISBN 0-433-44664-1 (PDF)

Subscription rates: \$260
\$360 (Print & PDF)

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trust remedy is to be of any effect in insolvency proceedings, an amendment is required to the legislation; yet to date, the legislators have failed to act.

The experience in Australia, which has had prompt payment legislation for several decades, demonstrates that prompt payment legislation does not necessarily prevent insolvencies of construction companies, as insolvencies of such companies in New South Wales are at an all-time high. A move to pass similar legislation in Ontario, which would have entitled contractors and trades to receive progress payments in a timely manner and to suspend work or terminate their contracts if the progress payments are not made, stalled in Committee.

A recent inquiry into construction industry insolvency in New South Wales made two major recommendations: The first relates to the introduction of a construction trust similar to that in Ontario. The second major recommendation was the use of project bank accounts (PBAs). Recent commentary concludes that the formal trust created by PBAs is to be preferred over the construction trust because of higher transparency, efficiency, and additional protection to contractors, trades, and suppliers.¹

However, neither prompt payment legislation nor construction trusts, although laudable, are a complete answer. As other jurisdictions move to PBAs, the time has come for Canada to consider their use.

Project Bank Accounts in Other Jurisdictions

In March 1998, the Law Reform Commission of Western Australia recommended the use of a statutory trust scheme, with the trustee segregating the funds in a trust account, separate from its general bank account. The New South Wales Inquiry mentioned above also recommended the use of a segregated trust account. The New South Wales government responded by introducing legislation that would require retention (holdback) funds to be placed in a segregated trust account. While the government was prepared to try project-specific bank accounts for certain government projects, it was not prepared to introduce the concept of the trust.

In the United Kingdom, government agencies have undertaken a pilot project to introduce PBAs. In a Cabinet Office 2012 briefing document, the government set out that “Government Construction Board members have committed, over the next three years, to deliver £4bn worth of construction projects using PBAs”. The U.K. Government Cabinet Office’s guide to implementing PBAs states that a PBA “is linked to a Trust Deed, and provides insolvency protection for the supply chain”. The Briefing Document also identifies other benefits of a PBA as follows:

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.

PBAs have also been implemented in Northern Ireland. The guidance note on PBAs issued by Northern Ireland expressed similar benefits: “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”.

Common Law Trust Status

A PBA is described as a “ring fenced” bank account into which the owner makes its payment and from which payments are made to the contractor and the 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.

The trust status of a PBA is established by a series of agreements, or trust deeds. The Northern Ireland model, for example, requires the owner and the contractor jointly to open the PBA, execute a trust deed related to the account, provide sample authorized signatures to the bank, and the owner, contractor, and trades or suppliers execute a “Joining Deed”.

Under the U.K. model, similar trust deeds are executed by the parties. The U.K. model permits a Dual Authority account, where the owner and the contractor are joint trustees, or a Single Authority account, where only the contractor is the trustee. Trades known at the time of contract would sign the trust deed, and new trades would execute a Deed of Adherence or a Joining Deed, depending on the model used. Where the Dual Authority account is used, the owner and contractor have to both authorize the payment to the contractor and to the trades. Where an owner has cut back the draw, all payments to the contractor and the trade are reduced *pro rata*. Under the Single Authority model, after the progress payment is agreed upon, the contractor authorizes the bank to pay the contractor and the trades. Also, where the owner cuts back the draw, the contractor has the option of topping up the account. In any event, whether a Dual Authority or Single Authority account is used, the intent is not to alter in any way the protection offered in terms of the security of the funds. To adapt PBAs for use in Canada, other rules may be adopted regarding the operation of the PBA. For example, the U.K. PBA model is coupled with fair payment practices so that payment is made by the owner in a timely manner and then payment to the contractor and trades occurs within days of deposit of the funds by the owner.

The End of Priority Disputes

If owners started to require 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 this risk. The owner would be holding on to 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 would vanish, as the funds would be held in a trust account that meets the elements of a common law trust.

The priority disputes in insolvency proceedings can be relegated to a memory by the use of PBAs that satisfy the elements of a common law trust. As the legislators have failed to act, the push for the use of PBAs will undoubtedly have to come from the private sector, and the time for the use of PBAs is now.

¹ Michael McCagh, “Adequately Protecting Construction Insolvencies: Disposition of Trust to Facilitate Security of Payment in Australia”, *Journal of Legal Affairs and Dispute Resolution in Engineering and Construction* 7 (2015): 1.