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As Director of Legal Research at Torkin Manes, Marco provides legal opinions and analyses on a range of topics in the civil litigation and corporate/commercial context. He has drafted legal memoranda, facta and materials for all levels of court, with a particular emphasis on appellate cases.

Trust Funds Under *CLA* Must Meet Common Law Definition of Trust to Survive a Bankruptcy

THE ONTARIO SUPERIOR COURT HAS VERY RECENTLY HELD THAT WHERE THE PRIMARY DEBTOR IS A BANKRUPT, A MATERIAL SUPPLIER'S CLAIM TO STATUTORY TRUST FUNDS UNDER THE *CONSTRUCTION LIEN ACT* MUST MEET THE COMMON LAW DEFINITION OF A TRUST IN ORDER TO SURVIVE THE BANKRUPTCY OF THE DEBTOR COMPANY TO WHICH MATERIALS WERE SUPPLIED. THE COURT FURTHER HELD THAT A MATERIAL SUPPLIER WHICH SUPPLIES PRODUCT TO ITS CUSTOMER, WHO IN TURN INCORPORATES THE MATERIAL INTO NEW MATERIAL FOR SALE TO THE PUBLIC, IS A TRUST BENEFICIARY ON ACCOUNT OF THE MATERIAL USED AT A CONSTRUCTION PROJECT.

In *Royal Bank of Canada v. Atlas Block Co.*, 2014 ONSC 3062 (Sup. Ct.), per Penny J., at issue was whether the supplier of materials that were incorporated into a bankrupt company's manufactured products had a trust claim under the *Construction Lien Act*, R.S.O. 1990, c.C.30 (the "*CLA*"). The receiver and trustee in bankruptcy of the insolvent company, KPMG, was appointed by Royal Bank of Canada ("RBC") and moved for directions on this issue.

Atlas Block Co. ("Atlas") was a family-owned group of companies that manufactured a range of concrete building and landscaping products including paving stones, masonry, concrete veneers and concrete blocks. The material supplier, Holcim (Canada) Inc. ("Holcim"), supplied Atlas with loose cement powder, which was blown into silos and bagged cement powder. Holcim's cement powder was used to manufacture virtually all of Atlas' finished products. Atlas' products were sold to general

contractors and owners as well as to the public and to dealers who sold to retailers. The majority of Atlas' products which were sold to construction projects were concrete blocks and bagged goods. At the time of KPMG's appointment, general contractors and owners owed millions of dollars to Atlas. KPMG was successful in collecting a significant sum of money from these various construction contractors and owners.

In October, 2013, a receiver was appointed over all of Atlas' assets, undertakings and property, i.e. KPMG. In December, 2013, Atlas made assignments into bankruptcy. At the time of KPMG's appointment, Atlas had 440 accounts receivable and approximately 50% of Atlas' customers were construction contractors/owners/builders.

On this motion, KPMG took the position that Holcim did not have a trust claim under the *CLA* because it was impossible to discern whether there was any connection between the amounts owing by and collected from Atlas' large construction customers and the materials supplied by Holcim. RBC took the position that Holcim was not a trust beneficiary because KPMG mingled all of the money it collected into one account, i.e. money from retail operations as well as from construction projects.

In order to establish a trust under section 8 of the *CLA*, Holcim had to establish:

- i. Atlas was a contractor or a subcontractor;
- ii. Holcim supplied material to projects for which Atlas was a contractor or subcontractor;
- iii. Atlas received or was owed money on account of its contract or subcontract price for materials supplied to the improvement; and
- iv. Atlas owes Holcim money in respect of those materials.

First, the Court rejected KPMG's argument that merely because Atlas sold some of its products to retail customers in addition to construction projects, Holcim had lost its right to assert a trust claim under section 8 of the *CLA*. The fact that Atlas had some retail customers was not, in principle, a bar to Holcim's ability to assert a trust claim over monies identifiably owed by and collected from "large, identified construction products".

Second, the Court further rejected the argument that Holcim's trust claim was barred under the *CLA* because every grain of cement powder supplied to Atlas for which Holcim had not been paid could not be traced to a specific product supplied to a specific construction project for which KPMG collected payment.

Most important however, and for the first time in Ontario, the Court held that even if Holcim had a theoretical trust claim under section 8 of the

CLA, the claim did not survive Atlas' bankruptcy.

Section 67(1)(a) of the federal *Bankruptcy and Insolvency Act*, R.S.C. 1985, c.T-3 (the "*BIA*") excludes from the bankrupt's estate property divisible among the creditors of the bankrupt that is "property held by the bankrupt in trust for any other person". However, based on authority from the Supreme Court of Canada, section 67(1)(a) does not extend to assets subject to a provincial statutory deemed trust where such a deemed trust does not otherwise have all the attributes of a valid trust at common law.

At common law, a trust depends on three certainties:

- i. certainty of intention;
- ii. certainty of subject-matter; and
- iii. certainty of object.

In the instant case, the "certainty of subject-matter" requirement of a common law trust was not met because KPMG did not segregate payments it collected from construction projects for products sold which contained Holcim's material and money it collected from Atlas' retail operation.

Since KPMG was under no obligation to establish and maintain a separate account for funds received from construction projects on account of products sold containing Holcim cement powder, all of the money it collected from all sources went into one bank account. Accordingly,

where funds from construction projects were co-mingled with funds from other sources (i.e. non-trust funds), there was no certainty of subject-matter. The funds in KPMG's account did not meet the test for a trust at common law and accordingly were not exempt from the bankrupt's estate and Holcim's

right to assert a priority claim over the construction project funds was lost. In the end, the Federal legislation, i.e. the *BIA*, extinguished the priority claim of parties supplying services and materials to construction projects which they otherwise had under the *CLA*.

The cases cited in *Atlas* were recently considered by an Alberta Court of Queen's Bench, which reached a similar conclusion as the Ontario Superior Court in *Atlas*. The Alberta decision is now under appeal: see *Iona Contractors Ltd. v. Guarantee Co. of North America*, 2014 ABQB 347, per Eidsvik J.