

TAB 6

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

2013 ABCA 302
Alberta Court of Appeal

Horizon Earthworks Ltd., Re

2013 CarswellAlta 1661, 2013 ABCA 302, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817, 232 A.C.W.S. (3d) 580, 25 C.L.R. (4th) 1, 2 P.P.S.A.C. (4th) 16, 556 A.R. 344, 584 W.A.C. 344, 5 C.B.R. (6th) 69, 87 Alta. L.R. (5th) 335

The Municipal District of Greenview No. 16 Appellant (Plaintiff) and The Bank of Nova Scotia, Deloitte & Touche Inc. and Western Surety Company Respondent (Defendant)

Carole Conrad, Jack Watson, J.D. Bruce McDonald J.J.A.

Heard: May 2, 2013
Judgment: September 10, 2013
Docket: Edmonton Appeal 1203-0069-AC

Proceedings: reversing *Horizon Earthworks Ltd., Re* (2011), 19 P.P.S.A.C. (3d) 153, 86 C.B.R. (5th) 56, 2011 CarswellAlta 2215, 2011 ABQB 799 (Alta. Q.B.)

Counsel: M.J. McCabe, Q.C. for Appellant, Municipal District of Greenview No. 16
D.R. Bieganek, Q.C. for Respondent, Bank of Nova Scotia
R.C. Rutman for Respondent, Deloitte & Touche Inc.
E.A. Olszewski, Q.C., D.M. Nowak for Respondent, Western Surety Company

Subject: Insolvency; Corporate and Commercial; Civil Practice and Procedure

Related Abridgment Classifications

Bankruptcy and insolvency

X Priorities of claims

X.7 Unsecured claims

X.7.b Priority with respect to secured creditors

Personal property security

IV Priority of security interest

IV.6 Security interests versus other interests

IV.6.e Miscellaneous

Headnote

Bankruptcy and insolvency --- Priorities of claims — Unsecured claims — Priority with respect to secured creditors
Municipality entered into contract with HZ where HZ would perform local road-grading and other work — Contract price was estimated at \$1,497,824 — HZ was paid approximately \$723,560 when it ceased working on project and left about \$900,000 unpaid to creditors — HZ declared bankruptcy — Contract was bonded through respondent WS — Third party contractor PW completed work, which was arranged for by WS and paid for by municipality — Municipality sought to pay unpaid creditors difference between original contract price and amounts paid by it to HZ for work done and to PW to complete project — Bank held perfected security interest to any accounts receivable due or to become due to HZ at bankruptcy — Bank and WS both sought to be paid disputed amount — Trustee of HZ applied for advice and directions to determine which party was entitled to funds potentially owing to HZ by municipality pursuant to contract — Chambers judge

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

determined that any money potentially owing by municipality to HZ under contract was payable to bank — Municipality appealed — Appeal allowed — Chambers judge erred in directing money to be paid from municipality to HZ without addressing issue of whether and how money was owed to HZ in circumstances where HZ walked off project and failed to remedy defaults — Bank had priority to any funds owing to HZ but whether and how money was owed was separate issue — Debt had to first be established — Trial was directed to determine issue of whether, at date of bankruptcy, funds were owed by municipality to HZ pursuant to contract.

Personal property security --- Priority of security interest — Security interests versus other interests — Miscellaneous
Municipality entered into contract with HZ where HZ would perform local road-grading and other work — Contract price was estimated at \$1,497,824 — HZ was paid approximately \$723,560 when it ceased working on project and left about \$900,000 unpaid to creditors — HZ declared bankruptcy — Contract was bonded through respondent WS — Third party contractor PW completed work, which was arranged for by WS and paid for by municipality — Municipality sought to pay unpaid creditors difference between original contract price and amounts paid by it to HZ for work done and to PW to complete project — Bank held perfected security interest to any accounts receivable due or to become due to HZ at bankruptcy — Bank and WS both sought to be paid disputed amount — Trustee of HZ applied for advice and directions to determine which party was entitled to funds potentially owing to HZ by municipality pursuant to contract — Chambers judge determined that any money potentially owing by municipality to HZ under contract was payable to bank — Municipality appealed — Appeal allowed — Chambers judge erred in directing money to be paid from municipality to HZ without addressing issue of whether and how money was owed to HZ in circumstances where HZ walked off project and failed to remedy defaults — Bank had priority to any funds owing to HZ but whether and how money was owed was separate issue — Debt had to first be established — Trial was directed to determine issue of whether, at date of bankruptcy, funds were owed by municipality to HZ pursuant to contract.

Table of Authorities**Cases considered:**

A.N. Bail Co. v. Gingras (1982), 1982 CarswellQue 122, 54 N.R. 280, 1982 CarswellQue 122F, [1982] 2 S.C.R. 475 (S.C.C.) — considered

Tout & Finch Ltd., Re (1954), [1954] 1 W.L.R. 178 — considered

Wilkinson, Re (1905), [1905] 2 K.B. 713 (Eng. K.B.) — considered

Statutes considered:

Bankruptcy and Insolvency Act, R.S.C. 1985, c. B-3

Generally — referred to

s. 69.3 [en. 1992, c. 27, s. 36(1)] — considered

s. 71 — considered

s. 136 — considered

s. 141 — considered

Personal Property Security Act, R.S.A. 2000, c. P-7

Generally — referred to

s. 41(2) — considered

APPEAL by municipality from judgment reported at *Horizon Earthworks Ltd., Re* (2011), 19 P.P.S.A.C. (3d) 153, 86 C.B.R. (5th) 56, 2011 CarswellAlta 2215, 2011 ABQB 799 (Alta. Q.B.), giving advice and directions as to disputed funds.

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

Per curiam:

I. Introduction

1 This appeal deals with the interplay between a municipality's contractual right to pay unpaid creditors under a construction contract and the terms of the *Bankruptcy and Insolvency Act*, RSC 1985, c B-3, as amended (*BIA*), in the event of a contractor's bankruptcy.

2 The appellant, the Municipal District of Greenview No. 16, (Greenview) entered into a contract with Horizon Earthworks Ltd. (Horizon) on October 15, 2008, whereby Horizon would perform local road-grading and other work relating to Harper Creek Road (Harper Creek Contract). The contract price was estimated at \$1,497,824.00. Horizon was paid approximately \$723,560.00 when it ceased work on the project and left approximately \$900,000 unpaid to creditors. The contract was bonded through Western Surety Company (Western Surety) and the work was eventually completed by Petrowest Construction Ltd. (Petrowest) a third party contractor arranged for by Western Surety and paid for by Greenview. Western Surety also paid \$283,302.67 to unpaid creditors under a labour and materials bond.

3 Greenview seeks to pay the unpaid creditors the difference between the original contract price and the amounts paid by it to Horizon for work done and to Petrowest to complete the project (the disputed amount). The Bank of Nova Scotia (the Bank) holds perfected security to any accounts receivable due or to become due to Horizon at bankruptcy. The Bank and Western Surety both seek to be paid the disputed amount.

II. Issues:

1. Did the chambers judge err in determining any money potentially owing by Greenview to Horizon under the Harper Creek Contract was payable to the Bank?
2. Did the trial judge err by directing that Greenview pay the disputed amount to the Bank without determining how and if money was owing to Horizon on the facts and circumstances here?

III. Decision

4 The Trustee's application for advice and directions was to determine which party is entitled to any funds potentially owing to Horizon by Greenview pursuant to the Harper Creek Contract. The chambers judge did not err to the extent that his decision would answer the Trustee's question by finding that any monies potentially owing by Greenview to Horizon under the Harper Creek Contract were payable to the Bank, by virtue of the perfection of its security interest under the *Personal Property Security Act*, RSA 2000, c P-7 (*PPSA*). Similarly, the chambers judge did not err in finding that the contractual agreements with Greenview did not allow it to pay third party creditors any monies that were owing to Horizon at the date of its bankruptcy.

5 The chambers judge did err, however, in directing monies to be paid from Greenview to Horizon without addressing the issue of whether and how monies were owed to Horizon under circumstances where Horizon walked off the project and failed to remedy the defaults following Notice of Default. The chambers judge did not address this issue, no doubt due to the lack of complete argument on that point. Although touched upon in argument on appeal, this issue was not fully canvassed. This issue raises interesting questions surrounding the bonding agreements and whether, if Horizon must rely upon the bonding documentation to establish a debt, Horizon is also caught with the burdens of those agreements. Although the Bank has priority to any funds owing to Horizon, whether and how monies were, in fact, owed is a separate issue.

6 We direct a trial of the issue of whether, at the date of bankruptcy, there was a debt due or to be due from Greenview to

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

Horizon pursuant to the Harper Creek Contract.

7 We allow the appeal and direct the monies be returned to Greenview. There should be a trial of the issue as to whether, having regard to all of the circumstances of this case, funds were owed as at the date of Horizon's bankruptcy to Horizon by Greenview.

IV. Background

8 In an effort to protect sub-trades who are prohibited from filing liens against a municipality, the parties built various clauses into the Harper Creek Contract to protect unpaid creditors. Horizon and Western Surety also entered into documentation relating to a Performance Bond, and Labour and Material Payment Bond, provided by Western Surety, aimed at protecting unpaid creditors.

9 The Bank was Horizon's banker and advanced funds to Horizon through an operating line of credit. The Bank obtained a General Security Agreement in May 2008 to secure repayment of Horizon's loans, whereby Horizon granted the Bank a security interest in all its present and after acquired personal property, including all accounts receivable (the GSA). The Bank registered a financial statement at the Alberta Personal Property Registry on June 3, 2008, protecting its interests under the GSA.

10 On October 20, 2008, Western Surety issued two bonds to Horizon: a Performance Bond, and a Labour and Material Payment Bond, each in the amount of \$761,661.00 (the Bonds). Part of the bonding arrangement included an earlier Indemnity and Security Agreement between Horizon and Western Surety entered on or about April 28, 2008 (ISA). That document was not registered pursuant to the *PPSA*.

11 Horizon ran into financial difficulty and on November 13, 2009, Deloitte & Touche (Deloitte) was appointed interim receiver and monitor of the property of Horizon. On or about December 17, 2009, Greenview declared Horizon to be in default of the Harper Creek Contract for:

- (a) discontinuing the provision of the services;
- (b) failing to provide the services with sufficient workers or material to promptly complete the contract; and
- (c) failing to promptly pay its creditors for labour, services, equipment and related items.

Those defaults were not corrected.

12 Greenview estimates that when Horizon was declared in default, \$774,260.92 of the contract price had not been disbursed. Greenview made a claim under the Performance Bond and Western Surety arranged for Petrowest to complete the work under the contract pursuant to an agreement signed by Greenview, Petrowest and Western Surety. Petrowest completed that work and Greenview paid approximately \$383,000.00 for that completion.

13 Western Surety was also called upon to pay some creditors under the Labour and Material Payment Bond and on November 17, 2009, Western Surety wrote Greenview indicating that through its ISA with Horizon, Western Surety had an assignment of all funds due to Horizon under the Harper Creek Contract. The receiver Deloitte took issue with Western Surety's claim and instructed Greenview not to release any funds.

14 Greenview received notices from many of Horizon's subcontractors and suppliers that they had not been paid for work or materials. Greenview states that those third party claims total about \$922,807.12. On April 13, 2010, Horizon was assigned into bankruptcy and Deloitte was appointed Trustee. At the time of its bankruptcy, Horizon had several uncompleted contracts in different locations in Alberta, including the Harper Creek Contract. The Trustee filed a report indicating its understanding that several of the employee-related claims had been paid in full or in part through the Wage Earner Protection Program, and some of Horizon's books and records suggest there may be some differences in the amounts still owing. Despite any dispute about the exact amount of the claims, it is common ground that these claims vastly exceed the disputed

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

amount. Western Surety has settled and paid some of the claims made pursuant to the Labour and Material Payment Bond, and indicates that others may be pending. To date it has paid \$283,302.67 of the claims under the Bond.

15 Although a named respondent, the Trustee in bankruptcy took no part in this appeal. It determined that the Bank's security took priority over all other contractual secured creditors insofar as the inventory, receivables, book debts and other intangibles of Horizon along with the proceeds thereof were involved, and that Roynat (another secured creditor) took priority over all other contractual secured creditors concerning all other personal property of Horizon. Roynat, the Bank and the Deloitte entered into an assignment agreement, wherein the Trustee assigned its interest in any and all remaining assets of Horizon to the Bank and Roynat, as the case may be. As part of the agreement, the Trustee assigned, among other things, all its right, title and interest in the remaining book debts of Horizon to the Bank in exchange for a credit against the indebtedness owed by Horizon to the Bank. The court approved the assignment agreement, discharged Deloitte on June 2, 2011, and the Bank was substituted in the Trustee's place if the subject matter of the legal proceeding concerned inventory, receivables, book debts, or other intangible assets of Horizon, or the proceeds thereof. The assets in issue here are any accounts receivable that may be owing under the Harper Creek Contract.

16 Deloitte also confirmed that there are no funds or other assets in the estate of Horizon in bankruptcy.

V. The Applications

17 Deloitte, as Trustee in bankruptcy, brought the initial application for advice and direction as to which party was entitled to any funds potentially owing to the bankrupt Horizon by Greenview pursuant to the Harper Creek Contract. Greenview sought advice and direction as to whether it can directly pay subcontractors and suppliers of the bankrupt Horizon out of any funds not disbursed under the Harper Creek Contract. The Bank filed a cross-application seeking a declaration that it has a perfected security interest and priority to what it refers to as the Harper Creek funds and sought a direction to have Greenview pay those funds to Horizon. Western Surety sought the right to any funds unpaid under the Harper Creek Contract on behalf of the unpaid subcontractors who have issued, or may issue, claims under the Labour and Material Payment Bond by virtue of the ISA with Horizon, or alternatively by virtue of the application of the doctrines of set-off and subrogation.

VI. The Chambers Decision

18 The chambers judge rejected Greenview's argument that it could pay Horizon's unpaid creditors pursuant to the terms of the Harper Creek Contract and bond documents. He found that such a proposal was not compliant with the terms of the *BIA*, dealing with the priority of claims in a bankruptcy, specifically sections 136 and 141.

19 The chambers judge concluded that the unsecured subcontractors and suppliers are unsecured creditors of the bankrupt Horizon, and not of Greenview. He observed that the circumstances here are covered by sections 136 and 141 of the *BIA* which set out the priority regime for secured and unsecured creditors of a bankrupt. If there is anything left to share, then it is to be shared with all unsecured creditors of Horizon and not just those creditors under the Harper Creek Contract. The chambers judge accepted the Trustee's submission that Greenview's proposal was a private reorganization of the priority regime of the *BIA*, and that to allow parties to construct their own priority regimes outside of the regimes mandated by the *BIA* would create a potential for significant mischief. In addition, he listed several public policy reasons to support his decision, including the desirability of a high level of certainty and predictability for all manner of creditors and the importance of the priority regime of the *BIA* to timely resolution of claims. He stated at para 40:

In summary, the *BIA* provides a scheme to create certainty in respect to competing claims and to bring the administration of the affairs of a bankrupt to a timely and predictable conclusion. This sort of end-run around the legislation which is proposed here should not be and will not be allowed by this Court.

20 The chambers judge went on to make an alternative finding. He concluded that the GSA granted by Horizon to the Bank was a security interest in all of Horizon's present and after acquired property, including accounts receivable. The Bank had registered its security interest arising from the GSA by way of a financing statement under the *PPSA* and that registration was effective as at June 3, 2008. As a result, he found that when Horizon entered into the Harper Creek Contract, this created

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

an account subject to the registered security interest of the Bank. He found that the Bank had a security interest in priority to Western Surety because Western Surety had not registered its assignment of any book debts. That assignment read as follows:

Clause 20.: *Assignment of the Principal's rights* — As a continuing and collateral security for the obligations of the Indemnitors towards the Surety under this agreement, each Principal hereby grants, bargains, sells and conveys to the Surety, a continuing, specific and fixed assignment, transfer, mortgage, charge and security interest in the following:

- a) all of the claims and debts which it holds against all persons, and without limitation, against:
 - i) all persons with whom it has or will enter into Bonded Contracts; and

...

21 As a result, the chambers judge found that while Western Surety could have registered this assignment, its failure to do so meant the Trustee, and therefore the Bank, took free of that assignment.

22 The chambers judge directed that the disputed amount be paid forthwith to the Bank.

VII. Standard of Review

23 The parties agree that the issues in this appeal are questions of law which require a standard of correctness.

VIII. Position of the Parties

A. Greenview's Position

24 Greenview seeks to pay to unpaid creditors, pursuant to the Harper Creek Contract, money it had as a result of fortuitously completing the contract by a third party arranged by Western Surety for less than the amount of the original contract price. Greenview argues that the Supreme Court of Canada decision in *A.N. Bail Co. v. Gingras*, [1982] 2 S.C.R. 475 (S.C.C.) supports its position because the totality of the documents, including the contract, the Bonds and the ISA, work together to create a relationship with the unpaid third party creditors which was missing in *Bail*. It argues that *Bail* was decided in large part due to the lack of any such connection. Here, Greenview argues that the bonding contracts create a relationship with unpaid creditors to provide for their payment and to ensure that funds are held in trust pending payment.

25 In any event, Greenview argues that there is no money owing to Horizon as it was in fundamental breach of its contract. Greenview says Horizon had been given notice of default prior to the bankruptcy for (a) discontinuing the provision of the services; (b) failing to provide services with sufficient workers or material to promptly complete the contract; and (c) failing to promptly pay its creditors as required under the Harper Creek Contract. Having failed to remedy its default, and complete the contract in accordance with its terms, Greenview argues that no funds are owing to Horizon and therefore no accounts due or to become due under the contract. The fact that the work was not complete and money owing to Horizon at the date of the bankruptcy distinguishes this case from *Bail*. Simply because the work was completed by a third party for less than the contract price does not entitle Horizon to sue for the difference where it had ceased work and was in breach of its covenants to pay third party creditors.

26 In any event, Greenview argues that the combination of the Harper Creek Contract, the Bonds and the ISA create a trust relationship whereby Horizon expressly agrees that funds due or to become due to Horizon under a bonded contract, whether held by Horizon or otherwise, are expressly declared to be trust funds for the benefit of its creditors, who are the beneficiaries of that declaration of trust. Moreover, the Labour and Material Payment Bond creates a relationship between the owner and the third parties in that it provides that Greenview, as Obligee, can bring claims for third parties. Thus, even if Horizon could be said to be entitled to funds over the amount paid to complete the work, those funds are impressed with a

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

trust in favour of third party creditors and therefore Horizon could not sue for the difference.

B. Western Surety's Position

27 The respondent, Western Surety, generally supports Greenview's position but asks that the funds be delivered to it instead of the subcontractors directly under the Bonds or, at a minimum, seeks its *pro rata* share for creditors paid and to be paid. Western Surety also argues that as a guarantor under the ISA and the Bonds, it is entitled to the funds under the equitable relief of subrogation and set-off. Western Surety argues further that the bankruptcy is not determinative here because the funds held by Greenview are held in trust pursuant to the agreement between Horizon and Western Surety pursuant to the Bonds and the ISA, wherein Horizon specifically agrees that any funds owing are impressed with a trust until such time as Horizon completes all its work and performs all its obligations, and Horizon would not have an action under the Harper Creek Contract.

28 Western Surety acknowledges that while the Bank holds a security interest in Horizon's accounts receivable under its GSA, which was perfected, there must be in existence accounts due or to become due to which the security attaches and even section 41(2) of the *PPSA* confirms that a creditor's right to payment under a contract is subject to the conditions in the contract.

C. The Bank's Position

29 The respondent Bank maintains that the chambers judge was correct to order Greenview to pay the funds. It argues that the trust language in the Bonds does not create a legal relationship between Greenview and the subcontractors so as to distinguish *Bail*. Rather, the Bank says that any claims by the subcontractors are pursuant to the Bond as against Western Surety and not a claim to the funds under the contract. Moreover, it denies that Western Surety is subrogated to the rights of Greenview since the equitable relief Western Surety seeks has no basis in Canadian law. Finally, the Bank argues that its perfected security interest, the GSA, attaches to the Harper Creek Contract and because the ISA is likewise covered by the *PPSA*, but is not registered, the Bank's security prevails.

30 As noted previously, the Trustee did not participate in this appeal.

IX. Analysis

Issue 1: Did the Chambers judge err in determining that any money potentially owing by Greenview to Horizon under the Harper Creek Contract was payable to the Bank?

31 The contractual arrangements present in this appeal are motivated, in part, by the inability of subcontractors and suppliers to file liens for work on public highways. The Harper Creek Contract contained several clauses aimed at ensuring payment of third party claims. In addition, the ISA between Horizon and Western Surety, and the Bonds contained several conditions intended to protect unpaid creditors.

32 Relevant provisions of the Harper Creek Contract include:

1.2.26.2 Holdback

The Department will retain holdback in the amount of 10% of the value of each progress estimate.

...

1.2.26.4 Increase in Holdback

The Department may increase the amount of holdback retained by the total amount of any outstanding third party claims, deficiencies in the work or unpaid back charges.

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

...

1.2.26.6 Release of Holdback

After a minimum of 45 days has expired from the date of Construction Completion, the Department will release the full amount of the holdback to the Contractor provided that all of the following have occurred:

- (i) All Work has been completed and accepted by the Department and the Contractor has complied with all the terms of the Contract excluding his obligations under section 1.2.53, Contractor's Warranty and Final Acceptance.
- (ii) There are no outstanding third party claims filed with the Department.

...

If the Contractor fails to meet his obligations with respect to any of these items, the Department may use holdback funds to rectify the deficiency, in accordance with the terms of the Contract and the Public Works Act.

33 In seeking a direction allowing Greenview to pay creditors up to the disputed funds, Greenview relies, in part, upon the following language of the Harper Creek Contract:

1.2.35 Payment for Labour and Material

The Contractor shall promptly pay, or ensure that prompt payment is made, for all labour, services, equipment, supplies and Material used for, on or about the Work, including any sum due from the Contractor, any subcontractor or any person, for the labour or services of any subcontractor, foreman, worker or other person, or for the use of plants, machinery or camp supplies. In the event of failure by the Contractor at any time to do so, or if the Department has reason to believe that such payments will not be promptly made, the Department may retain out of any money due on any account to the Contractor from the Department such amount as the Department may deem sufficient to satisfy the same giving him notice of such claims, requesting him to settle them directly and withholding the balance until the claims are satisfied. The Department may pay directly to any claimant such amount as the Department determines is owing, rendering to the Contractor the balance due after deducting the payments so made.

When the liabilities of the Contractor under the Contract exceed the money owed to him on any account by the Department, the Contractor or the Surety shall pay all such claims as are certified by the Department to be correct.

34 In addition, it relied upon language of Clause 22 of the ISA between Horizon and Western Surety which provides:

Clause 22: *Trust Funds* -

a) The Principal agrees and hereby expressly declares that all funds due or to become due under any Bonded Contract, are, whether in the possession of the Principal or another, trust funds for the benefit of and payment to all persons to whom the Principal incurs, in the performance of such Bonded Contract, obligations for which the Surety would be liable under any Bond. If the Surety assumes or discharges any such obligation, it shall be entitled to assert the claim of such person to the trust funds;

b) The Principal shall, upon demand and in implementation of any trust hereby created, open an account or accounts with a bank or similar depository designated by the Principal and approved by the Surety, which account or accounts shall be designated as a trust account or accounts for the deposit of such trust funds, and shall deposit therein all monies received pursuant to said Bonded Contract or contracts. Withdrawals from such accounts shall be by cheque or similar instrument signed by the Principal and countersigned by a representative of the Surety.

c) Said trust or trusts shall terminate on the payment by the Principal of all the contractual obligations for the payment of which the trust or trusts are hereby created or upon the expiration of twenty years from the date hereof.

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

whichever shall first occur.

[Emphasis added.]

35 Greenview acknowledged that in light of the Supreme Court of Canada's decision in *Bail*, clause 1.2.35 alone is insufficient to justify its payment to creditors after bankruptcy. It argues, however, that the totality of the language under all of the contractual documents, including the Bonds, create a relationship between the unpaid creditors and Greenview which was missing in the leading authority from the Supreme Court of Canada. Greenview also says that here, where Horizon walked off the job and the work was not complete, there was no money owing.

36 *Bail*, the leading authority on this issue, dealt with the effect of bankruptcy on a clause similar to that of clause 1.2.35 of the Harper Creek Contract. In that case, the appellant Bail had contracted with the Defence Construction (1951) Ltd. on behalf of the Department of National Defence for design and construction of vehicle storage and maintenance facilities at the Canadian Forces Base at Valcartier. The contract contained Clause 21 which provided that "Her Majesty may, in order to discharged lawful obligations of and satisfy lawful claims against the Contractor or subcontractor arising out of the execution of the work, pay any amount which is due and payable to the Contractor pursuant to the Terms of Payment or is payable pursuant to section 41 of the General Conditions...". By virtue of a subcontract, Bail delegated the masonry work to Maçonnerie Montmorency Inc. That subcontract incorporated the terms allowing Bail the right to pay Maçonnerie Montmorency Inc's subtrades.

37 Maçonnerie Montmorency Inc went into bankruptcy. The Federal Crown instructed Bail to pay Tuyaux Vibrés Inc, Maçonnerie Montmorency Inc's material supplier, rather than the Trustee in bankruptcy, relying upon Clause 21. The Federal Crown argued that it wished to protect subcontractors and suppliers, and to ensure that their claims would be paid. It insisted on payment being made directly by Bail, because as the general contractor, Bail was in a better position to assess the merits and quantum of the supplier's claim.

38 The court posed the fundamental question as being whether a contractual clause permitting payment to an unpaid supplier could apply after bankruptcy, such that Bail's payment to the unpaid creditor of the bankrupt had the effect of releasing Bail from its obligation to the trustee in bankruptcy.

39 Bail relied on *Wilkinson, Re*, [1905] 2 K.B. 713 (Eng. K.B.); and *Tout & Finch Ltd., Re*, [1954] 1 W.L.R. 178, as support of its position. In *Wilkinson, Re*, A signed a contract with a local authority to contract sewage works. A term of the contract provided that if the engineer had reasonable cause to believe that the contract was unduly delaying proper payment to the firms supplying machinery, he had the power to direct payment to them. Bigham J concluded that the authority given by the contractor (the bankrupt) to the engineer to direct money which would otherwise come to him was an authority that could not be withdrawn by the bankrupt and it was never intended that it could be withdrawn. In arriving at his decision, Bigham J discussed all the worthy reasons why a council inserts such a clause, stating, in part, at 481-82 (*Bail*):

It is very much to the interest of the council to see that contracts of this kind for public works into which they enter are carried out in a manner satisfactory to all persons who are concerned in the performance of them. The council certainly may, and no doubt frequently do, make contracts of this kind, and they make them much more advantageously when the people who supply the machinery or other goods which are to be used by the contractor in the performance of the contract know that there is a reasonable probability that they will be paid.

40 The Supreme Court of Canada rejected the conclusion reached in *Wilkinson, Re*. Chouinard J found that the contractual term, revocable or not, does not supersede the bankruptcy. Greenview argues that the lack of a relationship between the owner and the unpaid creditors was fundamental to the reasoning in *Bail*, whereas here the totality of the documents creates a relationship between Greenview and the third party creditors. In particular, counsel for Greenview relies upon the following language in *Bail* at 485-87:

In the case at bar, the supplier of materials Tuyaux Vibrés Inc. is a complete stranger to the clause linking the owner and the general contractor, and between the latter and the bankrupt subcontractor.

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

Clause 21 contains only an option which the owner reserved in the principal contract, and appellant in its sub-contract: no obligation has been created.

There is no contract of guarantee which presupposes a contractual relationship between appellant and Tuyaux Vibrés Inc. (*Civil Code*, art. 1028).

There is no stipulation for the benefit of a third person, which requires that an obligation be undertaken by the promisor, whereas here neither appellant nor Defence Construction (1951) Ltd. has undertaken any obligation (*Civil Code*, art. 1029).

There is no novation, which would require the participation of Tuyaux Vibrés Inc.: the latter is a stranger to the contracts between Defence Construction (1951) Ltd. and appellant and between the latter and Maçonnerie Montmorency Inc. (*Civil Code*, arts. 1169 *et seq.*).

There is no delegation of payment, which assumes an obligation undertaken by the new debtor (*Civil Code*, art. 1173).

Finally, there is no assignment of a debt by Maçonnerie Montmorency Inc. to Tuyaux Vibrés Inc. (*Civil Code*, art. 1570).

There is no legal connection between Tuyaux Vibrés Inc. and appellant, nor between Tuyaux Vibrés Inc. and Defence Construction (1951) Ltd. Tuyaux Vibrés Inc. could not enforce any claim against either one or the other.

Its only claim is against the bankrupt company, Maçonnerie Montmorency Inc.

Its claim is neither preferred nor secured. Appellant indeed is not arguing the contrary.

The payment made by appellant to Tuyaux Vibrés Inc. remains a payment made on behalf of the bankrupt company, which as of the date of the bankruptcy can make no further payments (*Bankruptcy Act*, s. 50(5)).

From the date of the bankruptcy also, the debt of Maçonnerie Montmorency Inc. against appellant passed into the hands of the trustee as part of the property of the bankrupt company, and only the trustee can obtain payment of it (*Bankruptcy Act*, ss. 47, 50).

It would be to disregard the *Bankruptcy Act* and deprive it of all meaning if the debtor of a bankrupt, instead of paying the trustee, were authorized, by contract or some other means, to pay one or other of the creditors of the bankrupt as he saw fit.

41 Pursuant to section 71 of the *BIA*, upon a bankruptcy order being filed, a bankrupt ceases to have the capacity to dispose or otherwise deal with its property, which shall “subject to this Act and to the rights of secured creditors, immediately pass to and vest in the trustee named in the bankruptcy order...”. Upon bankruptcy Horizon’s creditors become creditors of the bankrupt estate. While a provisions such as clause 1.2.35 may allow payment of contractors and suppliers by Greenview from monies owing Horizon prior to bankruptcy, once bankruptcy occurs any monies owing become the property of the Trustee, and the terms of the contract do not replace the terms of the *BIA* to prefer some of Horizon’s creditors over others. Once Horizon was placed in bankruptcy, all creditors stand on an equal footing vis-à-vis Horizon, and claims must be submitted in accordance with the provisions of the *BIA* section 69.3. Further, clause 1.2.35 embodies a discretion, not a commitment, on the part of Greenview, the exercise of which would reduce what Greenview might owe to Horizon either for work already billed or work to be billed. Any unpaid subcontractors and suppliers not paid by Greenview remain creditors of Horizon, not Greenview, under that clause.

42 Greenview candidly acknowledges that if it had to rely solely upon clause 1.2.35, *Bail* would not allow payment by Greenview of monies owing to Horizon at bankruptcy. It submits, however, that considering the importance placed upon the relationship between the owner and the subtrades by the Supreme Court in *Bail*, this case is distinguishable having regard to the combination of documentation surrounding this transaction, including the Labour and Material Payment Bond, which allow it to present claims of creditors to Western Surety.

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

43 We disagree. In our view, the contractual arrangements here do not establish a relationship sufficient to distinguish *Bail*. Although there is language in the contracts between Horizon and Western Surety relating to unpaid funds being earmarked with a trust, Greenview is not a party to the Bonds or the ISA, and has no legal obligations under any of those agreements to pay unpaid creditors. While the Labour and Material Payment Bond says that Greenview, as Obligee under the Bonds, can bring claims on behalf of unpaid creditors, it does not require Greenview to do so. Nothing in any document places an obligation on Greenview to pay the unpaid creditors. Thus, if Greenview owes money to Horizon at bankruptcy pursuant to the Harper Creek Contract, that account receivable becomes the property of the Trustee.

44 In summary, if money is due or to become due Horizon under the Harper Creek Contract on the date of bankruptcy, an issue which is discussed later, that asset, subject to the rights of secured creditors, becomes the property of the Trustee upon bankruptcy. The Trustee has assigned any interest in accounts receivable to the Bank. Horizon had also assigned its receivables to the Bank under the GSA, which was registered pursuant to the *PPSA*. Although Western Surety held an earlier assignment of funds owed by an owner under a bonded contract, that security was not registered and therefore to the extent that a debt is owing, the Bank has priority.

Issue 2: Did the chambers judge err in directing Greenview to pay the disputed amount to the Bank without determining if and how any monies were owing to Horizon on the facts and circumstances here.

45 We are not in a position to determine whether the disputed amount is owed to Horizon. The chambers judge did not address the issue. Here, the work was not complete and Horizon had been paid approximately \$762,000.00 of a \$1.4 million contract for all work done to date. It ceased work before completion leaving approximately \$900,000 of unpaid third party claims. The work was incomplete at the date of bankruptcy. It was completed by Petrowest, an unrelated third party contractor arranged by Western Surety and paid for by Greenview. Under these circumstances we are of the view that there is a live issue as to whether Horizon, on the facts here, could successfully prosecute a claim against Greenview for any amount in which there would be no account receivable to pass to the Trustee on bankruptcy.

46 The Bank's security also only protects valid accounts due to Horizon. The Bank's secured interest, duly registered, stems from the GSA between Horizon and the Bank which provides:

1. Horizon Earthworks ...grants to the Bank, a security interest in the present and after acquired undertaking and property... of the Customer including without limitation all the right title, interest and benefit which the Customer now has or may hereafter have in all property of the kinds hereinafter described ...:

...

(c) all accounts, including deposit accounts in banks, credit unions, trust companies and similar institutions, debts, demands and choses in action which are now due, owing or accruing due or which may hereafter become due, owing or accruing due to the Customer, and all claims of any kind which the Customer now has or may hereafter have including but not limited to claims against the Crown and claims under insurance policies:

47 The Bank's interest is to such amount that is "due, owing or accruing due or which may hereafter become due, owing or accruing due" to Horizon. Horizon must have a valid claim against Greenview under the Harper Creek Contract to be captured by the Bank's security.

48 Interestingly, *Bail* is not helpful to the Bank on this point. The question of whether an account existed that would pass to the trustee was not in issue in *Bail*, as the work had been completed and the money, including any holdbacks, was owed by the owner to the appellant. Significantly, Chouinard J stated at 479:

Indeed, it appears from the evidence that **although the work had been completed and the holdbacks were due to be paid by the owner to Appellant**, the owner nonetheless held back approximately \$250,000.00, that is the normal holdback of \$200,000.00 which was due and payable to Appellant and a further special holdback of \$50,000.00 to cover the claim of the supplier TUYAUX VIBRES INC. in the amount of \$27,116.28.

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

[Emphasis added]

49 In *Bail*, there were also some different policy issues in play. For example, in *Bail* the court noted that the unpaid creditors were creditors of the bankrupt, and it was concerned with a creditor receiving preferential treatment from funds owed to the bankrupt. Here that is equally true should there be funds owing to Horizon. But of course the creditors are entitled to seek payment from other sources such as the Bonds without raising the same concerns.

50 Unfortunately, the chambers judge failed to address the issue of whether Horizon had a claim to the disputed amount having regard to its defaults and if so how. Although in his reasons, the chambers judge noted that, “If there is anything left to share...,” he then went on to direct all of the disputed funds to be paid to the Bank. He did not analyze the basis for finding that money was owed to Horizon in circumstances where Horizon walked off the project. We sympathize with the chambers judge because the arguments regarding whether a debt existed and how were not fully developed. Nonetheless, it is critical that the Bank establish an account receivable to Horizon at the relevant time before it is entitled to receive payment.

51 It is not clear as to how Horizon, which was paid for work done to the date of ceasing work, can establish that an account was due or to become due at the time of Horizon’s bankruptcy. We are not, however, prepared to make that finding without allowing Horizon the full opportunity to establish such a claim. In our view, although touched upon, the arguments surrounding this issue were not developed fully during the chamber application or on appeal. Our decision here does not foreclose any arguments that may be relevant between the parties in determining whether money is owing.

52 In summary, we are of the view that the chambers judge erred when he ordered Greenview to pay the disputed amount to the Bank at this time. The debt must be established first. The Trustee sought advice and direction as to which party was entitled to any funds *potentially* owing under the contract, suggesting that the Trustee was alive to the fact that there was a serious issue whether monies were owing.

53 The Bank sought a declaration that it was entitled to the funds. This is tantamount to seeking summary judgment that an amount was owing to Horizon from Greenview under the Harper Creek Contract, notwithstanding Horizon’s major defaults. We are satisfied that whether Horizon has a valid claim against Greenview is not only a live issue, but a serious one that should not be determined in a summary manner without full argument. These bonded contracts are no doubt common place and the results of completion and payment under those contracts are important issues. Western Surety raised arguments for the first time on appeal and no doubt further arguments as to the proper interpretation of the bonding documents will be developed in a trial of this issue.

54 In our view, the chambers judge erred in disposing of this important issue summarily by directing the disputed amounts to the Bank at this time. To that extent we allow the appeal and direct a trial of an issue as to whether Horizon is owed money under the Harper Creek Contract.

X. Conclusion

55 In answer to the Trustee’s application for advice and directions as to which party was entitled to any funds potentially owing to the bankrupt pursuant to the Harper Creek Contract, the chambers judge was correct in determining the Bank was entitled to any funds potentially owing.

56 The chambers judge erred, however, in directing a payment of the disputed amounts to the Bank without a determination of whether the disputed funds were owed by Greenview to Horizon in the circumstances of this case.

57 The appeal is allowed and the order directing that the disputed funds be paid by Greenview to the Bank is set aside and we order the disputed funds be returned to Greenview.

58 Should the parties wish to proceed further, we direct a trial of an issue as to whether Horizon is owed the disputed amount.

Appeal allowed.

Horizon Earthworks Ltd., Re, 2013 ABCA 302, 2013 CarswellAlta 1661

2013 ABCA 302, 2013 CarswellAlta 1661, [2013] A.W.L.D. 4728, [2013] A.W.L.D. 4817...

End of Document

Copyright © Thomson Reuters Canada Limited or its licensors (excluding individual court documents). All rights reserved.