

WATCH AS THAT TRUST IS SWEEP AWAY

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Suppliers and subcontractors in the construction industry should be mindful of a recent unreported decision of the Ontario Superior Court of Justice. In *Carillion Canada Inc. (Re)*, the Court held that an automatic cash sweep of Carillion's Ontario bank account rid the funds of their trust character leaving Carillion's subcontractors in Canada with no proprietary claim to \$22 million sitting in an overseas bank account maintained with a global bank (the "**Bank**").

Carillion's monitor (the "**Monitor**"), appointed further to Carillion's insolvency proceedings in Ontario, argued without success that the swept funds were the subject of a trust under the provisions of the *Construction Act* (Ontario) and, therefore, not available to Carillion's parent, the owner of the Bank account, or to the Bank in satisfaction of a set-off claim. The result is that Carillion's subcontractors in Canada are left only with an unsecured claim for breach of trust and breach of contract against Carillion Canada.

Background

The Applicants in these proceedings under the *Companies' Creditors Arrangement Act* ("**CCAA**") were part of a global construction and facilities management services conglomerate (the "**Carillion Group**"). The Respondent on the Monitor's motion, the Bank, provided certain banking services to this group, including a pooling and cash sweep service.

The Applicant, Carillion Construction Inc. ("**Carillion Construction**"), operated the Carillion Group's construction business in Ontario and was the general contractor for several significant construction projects. In this role, Carillion Construction received payment from project owners for improvements made to their properties from which Carillion Construction was obligated to pay the suppliers of materials and the subcontractors that performed work on the relevant construction project.

Pursuant to an agreement between Carillion Construction and the Bank, the funds paid for these projects were regularly swept from Carillion Construction's Canadian bank account and held in the Bank account in the name of Carillion Canada Inc., a sister corporation of Carillion Construction. Shortly after one such cash sweep, a British parent of the Carillion Group commenced insolvency proceedings in England that were followed by CCAA proceedings in Ontario. While the pooling arrangements and cash sweep options between Carillion and

the Bank ceased as a result of these proceedings, the funds paid to Carillion Construction for construction projects in Ontario remained in the Bank account (“**held funds**”).

When Carillion filed for protection under the CCAA, the Monitor maintained that \$21.7 million of the held funds were subject to the statutory trust provided for under the *Construction Act* and belonged to various unpaid suppliers and subcontractors of Carillion Construction. The Bank disagreed, maintaining that they held a contractual right of set-off as part of the pooling arrangement with Carillion Group and would hold onto the money until a decision on entitlement was reached.

The central question for the Court was, therefore, whether the funds in question satisfied the three certainties required to exclude them from Carillion Construction’s estate and consequently from the purview of the Bank’s right to set-off.

Construction Trusts and Insolvency

The *Construction Act* provides for a statutory trust for the benefit of unpaid suppliers and contractors. In particular, funds paid by an owner to a general contractor in connection with a given construction project are subject to a trust pursuant to sections 7 and 8 of the *Construction Act* for the benefit of any unpaid contractor or subcontractor that supplied goods or services to the project. The purpose of these trust provisions is to protect these amounts from outside creditors and ensure that each party be paid for the work or supplies provided.

The circumstances in which funds arguably subject to a *Construction Act* trust will qualify as trust funds for the purposes of the *Bankruptcy and Insolvency Act* (the “**BIA**”) are set out in a recent line of jurisprudence in Ontario. Where such circumstances are satisfied, the money in question will no longer be considered property of a bankrupt contractor available for distribution to creditors, but will constitute funds that are reserved for beneficiaries of the trust.

In *Guarantee Company of North America v. Royal Bank of Canada*,^[1] (“**GCNA**”) the Ontario Court of Appeal affirmed that any trust established by provincial legislation or statute must meet three general principles in order to qualify as a trust for the purposes of the BIA: (i) certainty of intention, (ii) certainty of object, and (iii) certainty of subject matter. For certainty of intention to be satisfied, a Court must find an obligation to hold property in trust for the benefit of another. The *GCNA* decision confirmed that the trust provisions in the *Construction Act* satisfy this requirement.^[2] For certainty of object, the beneficiaries of the trust must be ascertainable. Finally, for certainty of subject matter, both the property and funds that are subject to the trust must be identifiable.

Notably, the Court of Appeal in *GCNA* held that the comingling of funds in a single account from different

construction projects may still satisfy the required certainty of subject matter where these funds remained identifiable and traceable.^[3] Relying on similar principles, the Court in *Urbancorp Cumberland 2 GP Inc. (Re)*^[4] held that proceeds from the sale of a condominium property deposited into different accounts also containing amounts from other construction projects satisfied the three certainties of a trust. The Court held that comingling payments from different projects in a single bank account did not by itself eliminate the certainty of subject matter where the amounts could still be separately accounted for and readily identifiable.^[5]

The Decision

In *Carillion Canada Inc. (Re)*, Hailey J. found that certainty of subject matter, with respect to the Construction Act trust that might otherwise apply to funds Carillion received from various project owners, was lost. The funds paid had been comingled in the Bank account, and were then divided and converted by Carillion into nine bank accounts that were held by seven different entities. These steps served to eliminate any certainty of subject matter causing the funds to lose their character as trust funds.

The Court also took issue with the fact that these funds had also been used in part to pay debts owed by Carillion Construction. Accordingly, these funds had not been “separately accounted for” and could not be traced. This was an important difference distinguishing the facts from those in *GCNA*, where payments from multiple construction projects that remained in a single account and had not been “converted to other uses” were still considered identifiable for the purpose of a trust.^[6] As such, the funds paid to Carillion in the Bank account were no longer subject to the *Construction Act* trust for the benefit of subcontractors and Hailey J. dismissed the Monitor’s motion.

The Proposed Appeal

The Monitor moved for leave to appeal this decision. The central question behind the proposed appeal surrounded when statutory trusts pursuant to the *Construction Act* arise to exclude the trust assets from the estate of the applicant in a CCAA proceeding. The Monitor sought clarification on the circumstances in which certainty of subject matter exist where trust assets are deposited into a bank account also containing non-trust assets, and the circumstances in which a beneficiary might trace funds that were transferred to another account.

In argument on its motion for leave, the Monitor submitted that the Motions Judge erred in law by conflating ascertainability with the ability to trace funds. Specifically, the Monitor differentiated between the two concepts by explaining that ascertainability is the initial process of identifying the trust funds, while the tracing process allows trust beneficiaries to keep track of the trust funds to ensure that they are not converted and do not fall below the original amount.

In a unanimous decision, the Ontario Court of Appeal dismissed the motion for leave.^[7] The Court observed that tracing at common law and in equity fails where identification of trust property is not possible. Accordingly, the motion judge's finding that funds in the Bank account had been irreconcilably commingled was fatal to the Monitor's claim.

Take-Away

Despite the existence of cases over the last few years upholding *Construction Act* trusts in the context of an insolvency, this case shows potential limits of such trust claims and has significant ramifications for those operating, and providing financing to parties, within the construction sphere. Those expecting to be paid for services rendered or supplies provided during the course of a construction project ought to take note that the protection afforded by the trust provisions of the *Construction Act* only go so far where a general contractor is also being pursued by creditors. The Superior Court ruling of *Carillion Canada Inc. (Re)*, now final, suggests that these funds may lose their trust character merely by operation of common banking arrangements.

[1] *Guarantee Company of North America v. Royal Bank of Canada*, 2019 ONCA 9 [GCNA]

[2] *Ibid.* at para 3.

[3] *Ibid.* at para 3.

[4] *Urbancorp Cumberland 2 GP Inc. (Re)*, 2020 ONCA 197 [Urbancorp]

[5] *Ibid.* at para 63.

[6] *Ibid.* at para 86.

[7] *Carillion Canada Holdings Inc. (Re)*, 2021 ONCA 468

by [Jeff Levine](#) and [Paola Ramirez](#)

A Cautionary Note

The foregoing provides only an overview and does not constitute legal advice. Readers are cautioned against making any decisions based on this material alone. Rather, specific legal advice should be obtained.

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