



## Creditor Priority as between Factoring Companies and Lienholders in the Wake of the Alberta Decision in *Van T Holdings Inc. v. KCS Equipment Ltd.*

By *Karen Groulx\**

The recent decision from Alberta in *Van T Holdings Inc. v. KCS Equipment Ltd.*<sup>1</sup> should be of interest to factoring<sup>2</sup> companies and lien claimants as it considers the competing claims that can arise between creditors where contractors or subcontractors involved in the construction project become insolvent. The decision in *Van T Holdings* centers on a dispute over court-held funds between a Factor, Liquid Capital Exchange Corp. and lienholders. The dispute related to excavation and grading work performed in West Edmonton, Alberta, and arose after Van T Holdings Inc., the general contractor, was ordered to pay \$673,335.88 into court to have all liens discharged from title after its subcontractor, KCS Equipment Ltd., became insolvent.<sup>3</sup>

The Court concluded that the Crown's Enhanced Requirement to Pay pursuant to section 224(1.2) of the *Income Tax Act*<sup>4</sup> and section 317(3) of the *Excise Tax Act*<sup>5</sup> afforded it superior priority over the lienholders.<sup>6</sup> However, the Alberta court held, on the facts of the case, that the Factor enjoyed priority superior to that enjoyed by the Crown. Relying on the Supreme Court's decisions in *First Vancouver*<sup>7</sup> and *Port O'Call*<sup>8</sup>, Master Schlosser found that the subcontractor's obligation to deduct and remit employee's source deductions and GST gave rise to a deemed trust in favour of the Crown over assets of the tax debtor/subcontractor, KCS, held at the time or acquired after the time the trust arose (the moment it failed to remit its source deductions by the specified due date).<sup>9</sup> However, because the factoring agreement was perfected before the Crown's Enhanced Requirement to Pay, the Factor had a superior claim to proceeds of the factored invoice, regardless of whether or not the funds were in possession of the Crown.<sup>10</sup> In short, the court held that "a factored invoice would not be caught by an Enhanced RTP."<sup>11</sup>

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<sup>1</sup> 2012 ABQB 335 [*Van T Holdings*]

<sup>2</sup> Factoring is a financial transaction whereby a business sells its accounts receivable (i.e. invoices) to a third party (called a Factor) at a discount.

<sup>3</sup> *Van T Holdings*, *supra* note 1 at paras 2 and 7.

<sup>4</sup> RSC 1985, c 1.

<sup>5</sup> RSC 1985, c E-15.

<sup>6</sup> *Van T Holdings*, *supra* note 1 at para 15.

<sup>7</sup> *First Vancouver Finance v Canada (MNR)*, 2002 SCC 49.

<sup>8</sup> *Canada Trustco Mortgage Corp v Port O'Call Hotel Inc.*, [1996] 1 SCR 63.

<sup>9</sup> *Van T Holdings*, *supra* note 1 at paras 16 and 19.

<sup>10</sup> *Van T Holdings*, *supra* note 1, at para 34.

<sup>11</sup> *Ibid.*

Section 11(1) of the Alberta's *Builders' Lien Act*<sup>12</sup> (the "*Alberta Act*"), reads as follows: "A lien has priority over all judgments, executions, assignments, attachment, garnishment or receiving orders recovered, issued or made after the lien arises."<sup>13</sup> Because Master Schlosser viewed a factored account as an *absolute* assignment more akin to a sale transaction than an 'assignment' for the purposes of the *Alberta Act*, he determined that the rights of the Factor were absolute as against the lienholder.<sup>14</sup>

### **Is a factoring agreement merely an assignment, or is it an absolute assignment?**

#### ***Definition of a Factoring Agreement by the SCC in Port O'Call***

"A factoring of accounts receivable is based upon an absolute assignment of them. It is in effect a sale by a company of its accounts receivable at a discounted value to the factoring company for immediate consideration." (para 31)

It was determined by the Supreme Court of Canada in *Port O'Call*<sup>15</sup> that an assignment cannot be absolute if it is conditional in any way.

#### **Analysis with respect to Van T Holding's applicability in Ontario**

In *Van T Holdings*, Master Schlosser read "assignment" in section 11(1) of the *Alberta Act* as not including an "absolute assignment". Master Schlosser further determined that because the Factored invoices were "absolute assignments", as per the decision of the Supreme Court of Canada in **Port O'Call**<sup>16</sup>, section 11(1) did not apply to grant lienholders superior priority over the Factor. As a result, Master Schlosser determines that a Factor takes priority over a lienholder for the purpose of the *Alberta Act*.

There is nothing in the *Alberta Act* or cited jurisprudence suggesting that an "absolute assignment" is, necessarily, not included in the class of "assignments" referred to in section 11(1). Furthermore, the definition set out in Black's Law Dictionary of assignment ("the transfer of rights or property") and absolute assignment ("an assignment that leaves the assignor no interest in the property or right") leave open the possibility that "absolute assignment" is a species of "assignment".

Like the *Alberta Act*, Ontario's lienholder priority provision is largely ambiguous with respect to the meaning of "assignment".

#### **If Van T Holdings were tried in Ontario, a court would likely decide in favour of lienholders over Factors.**

Although the decision in *Van T Holdings* may be viewed as a victory for factoring companies in Alberta, the decision does not affect the position of factoring companies in Ontario since contractors and subcontractors enjoy additional protection by way of statutory trusts created pursuant to Part II of the *Ontario Act*.

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<sup>12</sup> RSA 2000, c B-7

<sup>13</sup> *Ibid.*

<sup>14</sup> *Ibid* at para 41.

<sup>15</sup> *Canada Trustco Mortgage Corp v Port O'Call Hotel Inc*, [1996] 1 SCR 63

<sup>16</sup> *Ibid.* at para 31.

Section 77 of the *Construction Lien Act*<sup>17</sup> (the “*Ontario Act*”) reads as follows:

The liens arising from an improvement have priority over all judgments, executions, assignments, attachments, garnishments and receiving orders except those executed or recovered upon before the time when the first lien arose in respect of the improvement.

In assessing the exportability of *Van T Holdings* to Ontario, one must be aware of the divide that exists between the Ontario and Alberta *Acts* with respect to trust provisions. For ease of comparison, the relevant sections are as follows:

<i>Alberta Act</i>	<i>Ontario Act</i>
<p><b>22(1)</b> Where</p> <p><b>(a)</b> a certificate of substantial performance is issued, and</p> <p><b>(b)</b> a payment is made by the owner after a certificate of substantial performance is issued</p> <p>the person who receives the payment, to the extent that the person owes money to persons who provided work or furnished materials for the work or materials in respect of which the certificate was issued, holds that money in trust for the benefit of those persons.</p>	<p><b>8(1)</b> All amounts,</p> <p><b>(a)</b> owing to a contractor or subcontractor, whether or not due or payable; or</p> <p><b>(b)</b> received by a contractor or subcontractor,</p> <p>on account of the contract or subcontract price of an improvement constitute a trust fund for the benefit of the subcontractors and other persons who have supplied services or materials to the improvement who are owed amounts by the contractor or subcontractor.</p>

Commentators remark that section 22 of the *Alberta Act* creates a “holdback” trust whereby money is held in trust after issuance of a certificate of substantial performance.<sup>18</sup> This stands in stark contrast to Ontario where a privity-based trust arises at the moment amounts become owed to a contractor.<sup>19</sup>

The critical difference between these provisions is that in Ontario a trust arises for the benefit of contractors *at the moment* an amount is owed to them (even before the work becomes due or payable). Under section 8 of the *Ontario Act*, a trust fund for the benefit of contractors and subcontractors who supply materials or services to a project arises as soon as amounts become payable to them under a contract with respect to an improvement, that is, when work commences.

If a contractor feels that a contractor or subcontractor, in its dealing with accounts receivable, has breached a section 8 trust, a certain procedure must be followed, as identified by the Divisional Court in *St Mary’s Cement Corp v Construc Ltd.*<sup>20</sup>:

<sup>17</sup> *Construction Lien Act*, R.S.O. 1990, c. C.30

<sup>18</sup> Bristow, Glaholt, Reynolds & Wise, *Construction Builders’ and Mechanics’ Liens in Canada*, looseleaf (Carswell, Toronto) at 9-3 [*Bristow, Glaholt, Reynolds & Wise*].

<sup>19</sup> *Ibid* at 9-3.

<sup>20</sup> (1997) 33 CLR (2d) 234 (ON Gen Div) as summarized by Howard Wise, *Manual of Construction Law*, looseleaf (Toronto: Carswell, 2012) at 5-71.

Where a breach of trust is alleged, the initial onus is on the plaintiff to prove the existence of the trust by showing that the contractor received monies on account of its contract for the project, and that the plaintiff supplied materials on that project, and was not paid. The onus then is on the contractor to show that its payments of trust funds complied with the *Construction Lien Act*. The contractor is accountable, and the onus is on it to justify any expenditure of the funds; if it fails to do so, it is liable for breach of trust.

In Ontario, the trust property held for the benefit of the subcontractor and other persons who have supplied services or materials includes all amounts, owing to the party higher up the construction pyramid, whether or not due or payable as well as amounts actually received by the party. Therefore, accounts receivable, in that they represent money owed by the owner to the contractor with respect to an improvement, are captured by a construction trust in Ontario. Under section 8(2) of the *Ontario Act*, the contractor or subcontractor, as trustee, is unable to appropriate or convert these owed amounts for its own use or for any use inconsistent with the trust.

Therefore, a factoring agreement entered into *after* the trust arises and without the consent of those contractors and subcontractors with a beneficial interest in the monies is inconsistent with the *Ontario Act*.

The issue regarding at what time the factoring agreement at issue was entered into in the *Van T Holdings* case was not addressed by the Court. Whether or not the factoring agreement at issue has priority over a trust claim depends upon the date the trust arose and the date the factoring agreement was entered into. Pursuant to section 8 of the Ontario *Construction Lien Act* a trust arises at the moment amounts become owed to a contractor, whereas under section 22 of Alberta's *Builders Lien Act*, a trust is imposed later when a substantial performance certificate is issued.

In Ontario if, as Master Schlosser held in Alberta, “a factored account is a sale, not a loan”<sup>21</sup> it is a sale of property subject to a statutory trust for the benefit of the contractors. Any subsequent assignment of an account receivable in Ontario is therefore subject to the pre-existing trust in favour of the contractor or subcontractor who supplied services or materials for the improvement of the property.

The decision in *Van T Holdings* shows just how difficult it can be to rely on construction lien jurisprudence from “foreign” jurisdictions. Commentators warn that case law in this area of law can be misleading given discrepancies in the language of provincial construction lien statutes.<sup>22</sup> Bristow, Glaholt, Reynolds & Wise lament the varied legal landscape in Canada with respect to construction liens:

A lack of national uniformity in statutory construction trusts in the provinces means that suppliers of labour and materials across provincial borders find themselves with differing degrees of protection and different methods of enforcement of their claims in different jurisdictions.<sup>23</sup>

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<sup>21</sup> *Van T Holdings*, *supra* note 1 at para 32.

<sup>22</sup> *Bristow, Glaholt, Reynolds & Wise, Construction Builders' and Mechanics' Liens in Canada*, looseleaf (Carswell, Toronto), *supra* note 23 at 9-4–9-5.

<sup>23</sup> *Bristow, Glaholt, Reynolds & Wise, supra* note 23 at 9-4.

Although steps have recently been made toward harmonization, most notably a set of amendments that came into effect in Nova Scotia in 2005<sup>24</sup> that brought that province's construction lien legislation closer to Ontario's, discrepancies between the *Acts* will continue to render jurisprudence from other provinces outside Ontario of reduced value and application for cases involving construction projects in Ontario.

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<sup>24</sup> Bill 58, *An Act to amend Chapter 277 of the Revised Statutes, 1989, the Mechanics' Lien Act*, 1st Sess, 59 Leg, Nova Scotia, 2004 (assented to 20 May 2004).