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Insolvency Law

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CCAA COURT CLARIFIES POSITION OF CREDITORS WITH LIENS AGAINST THIRD PARTY'S PROPERTY

In *Kerr Interior Systems Ltd.*, the Court of Queen's Bench of Alberta discussed a number of issues which arose as a result of two creditors registering builders liens against a third party's property in Saskatchewan.

The debtor companies manufactured prefabricated panels and other construction materials, primarily used in the construction of apartments, condominiums and care facilities. In November, 2007 the debtors sought and obtained protection from the Court of Queen's Bench of Alberta under the *Companies Creditors' Arrangement Act* (Canada) (the "CCAA"). The Order contained the usual broad stay of proceedings against the debtor companies and their property.

In due course the debtor applied to the Court for approval of its plan of arrangement (which had achieved the statutorily required support of creditors). However, two related creditors (the "Opposing Creditors") representing only 3% of the debt opposed the sanction application.

After the initial CCAA Order was granted, the Opposing Creditors registered liens against lands owned by third parties in Saskatchewan, which liens arose due to the Opposing Creditors' contractual arrangements with the debtors. The plan of arrangement created only one class of creditors being "unsecured creditors". The Opposing Creditors took the position that they were entitled to their own voting class as a result of the builders' liens they had filed against third party properties in Saskatchewan.

In commencing its discussion, the Court noted that the parties were in agreement that there was no conflict

between the provisions of the *Builders' Lien Act* (Saskatchewan) and the CCAA. Further, the parties were in agreement that if the Opposing Creditors fell within the definition of "secured creditors" within section 2 of the CCAA then section 5 of the CCAA required that they vote as members of a separate class. The Court noted that the failure to place secured creditors in a separate class could mean the debtors had not met the prerequisites for the Court sanction of the plan of arrangement.

The Court also considered the possibility that the Opposing Creditors were not secured creditors within the meaning of section 2 of the CCAA, but might nonetheless be entitled to vote as members of a separate class under section 4 of the CCAA because they were registered lien claimants in Saskatchewan or because of their status as beneficiaries of a trust created by the *Builders' Lien Act* (Saskatchewan).

In concluding its discussion on these points, the Court stated, commencing at paragraph 28:

28. In other words, those entitled to vote in a separate class on a plan of arrangement under the CCAA must fall within the definition of "secured creditor" in that legislation or for other reasons be separated into a distinct creditor class. On the first alternative, I conclude below that any potential secured creditor class would not include all creditors who have filed builders' liens under the Saskatchewan BLA. The issue is simply whether the 2 opposing creditors fall within that definition or not. No conflict exists between the federal and provincial act. They work together as 2 parts of a whole.

29. Had I been required to address the issue of whether holders of registered builders' liens on a third party property or beneficiaries of deemed trusts created under the Saskatchewan BLA are entitled to be classed separately for the purposes of voting on a plan of arrangement, even though they do not meet the definition of unsecured creditor in s. 2 of the CCAA, I would have considered the observations of LoVecchio J. in *Sulphur Corp. of Canada Ltd. (Re)*, [2002] A.J. No. 918 (Alta. Q.B.) at para. 35 to the effect that in the event of conflict between a provision in the CCAA and a provincial statute the former will prevail by application of the doctrine of paramountcy.

30. On my own part I note that Parliament carefully included within the definition of "secured creditor" in s. 2 of the CCAA only holders of liens on the debtor's property and excluded holders of liens on third party property. This implies that Parliament did not therefore intend that holders of liens registered against third party property be secured parties vis-à-vis the debtor; otherwise, it would have said so. Parliament, at least, expected that its legislation would prevail over any provincial legislation providing otherwise. [emphasis added]

In deciding that the Opposing Creditors are not "secured creditors" within the meaning of the CCAA, the Court stated, commencing at paragraph 43:

43. However, their builders' liens do not bring them within that definition of "secured creditor" because those liens were filed against third party property, ... rather than against property belonging to Kerr. Section 2 of the CCAA explicitly requires that a lien which creates secured creditor status is "...on or against...all or any property of a debtor company..."(emphasis added). Here the land against which [the Opposing Creditors] liens were registered *did not belong to the debtor*

44. [The Opposing Creditors] argued, however, that their liens have been replaced by claims against the \$150,000 fund held in court in Saskatchewan and that money belongs to Kerr so that this requirement has been met. This arguments fails on several grounds.

45. First, the order of Mr. Justice M.D. Action of the Court of Queen's Bench of Saskatchewan... which vacates the liens of each of [the Opposing Creditors] upon the payment into court of the \$150,000 expressly provides:

3. Neither the terms of the within Order nor the payment of the aforesaid security shall operate to entitle the Respondents or any other Lien Claimants to recover a sum greater than they would be entitled to recover under the Builders' Lien Act had the within Order not been granted or the said posting of security into Court not been paid.

4. The consent of Kerr shall not prejudice the legal position of Kerr, including, without restriction, that the matter of the liens noted herein, the validity thereof, the propriety of their filing and the amounts owing to the lien claimants by Kerr are matters that are properly dealt with under Kerr's *Companies Creditors Arrangement Act* proceedings in Alberta...

46. This provision means that [the Opposing Creditors] cannot improve their position as a result of the payment into court of these monies over and above what that position was through the filing of the builders' liens themselves. They cannot rely upon Kerr's failure to oppose the granting of that order on the basis that this would be the case and now argue the contrary.

47. Further the \$150,000 fund in court does not belong to Kerr. While it was paid into court in respect of an accounts payable owing to Kerr by the owner, that alone does not make it Kerr's property as it was paid only to discharge liens filed against third party property. As Justice Barclay stated in regard to a similar fund in *D & K Horizontal Drilling (1998) Ltd. (Trustee of) v. Alliance Pipeline Ltd.*, 2002 SKQB 86 (Sask Q.B.) at para. 19:

... the money paid into Court is not the property of the Bankrupt. It is uncontroverted that the funds paid into Court never came into the hands of the Bankrupt. The funds were paid directly into Court by Alliance by virtue of Alliance's obligation and liability to the lien claimants under s. 56(6) of the [Sask] BLA...

48. Further, this argument assumes that the critical date for determining whether a creditor meets the requirements of s.2 is the date of the vote on the Plan rather than the date of the granting of the stay order. While the \$150,000 fund existed on the date of the vote it did not exist prior to the granting of the stay order on November 7, 2007. The question of the time at which secured creditor status is to be determined has rarely been investigated by the courts because normally the stay which initiates the CCAA proceedings is honoured, and no creditor seeks to improve its status by unilateral action between the granting of the stay and the holding of the vote.

...

50. Last, I note that these funds were paid into court to discharge a lien which was filed in the face of a court order precluding [the Opposing Creditors] from so filing. This arguably contemptuous filing should not be allowed to put them in a better position than other subcontractors who had potential lien claims against Kerr relating to the 101 project but who complied with the stay order.

Lastly, the court considered whether the Opposing Creditors should have been placed in a separate voting class due to the nature of their claims, notwithstanding that they were not secured creditors. The court observed that s.4 of the CCAA anticipates that different classes of unsecured creditors may be created with each class voting separately. The Opposing Creditors argued that they should be placed in a separate class due to their builders' liens in Saskatchewan, which gave them additional rights when compared to general unsecured creditors, even if the liens did not constitute the Opposing Creditors as secured creditors.

The Court held that the Opposing Creditors' logic failed because:

1. The Opposing Creditors obtained their lien rights by filing builders' liens after the granting of, and in violation of, the stay provisions of the original CCAA order;
2. There were builders' lien claimants in Alberta with virtually the same rights, although some minor differences existed between the Alberta and Saskatchewan Builders' Lien Acts; and
3. Nothing in the CCAA or the case law states that those holding builders liens' against third party property must be considered a separate class for voting purposes.

For the foregoing reasons the court concluding that the Creditors were not secured creditors, nor were the opposing creditors entitled to vote as a separate class from other unsecured creditors.

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