Competing priorities under the model receivership order:

RBC v. Galmar

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Ontario and other provinces have adopted a form of model order that provides a baseline for the drafting of orders providing for receivership appointments.

The recent case of Royal Bank of Canada v. Galmar Electrical Contracting Inc. et al[1] has brought to light a hidden danger for court-appointed receivers and managers in Ontario's model receivership order.

Royal Bank (RBC) was a secured creditor of Galmar and related companies. By an ex parte order dated May 9, 2013, Grant Thornton Ltd. was appointed as a limited-purpose receiver of Galmar. Shortly thereafter, the appointment order was amended to include substantially all of the provisions of the model receivership order and the receiver was authorized to file assignments in bankruptcy on behalf of the debtors. As a result, the debtors became bankrupt.

For the next two years, the receiver proceeded in the ordinary course to administer the estates. The receivership assignment was complicated by the fact that the two principal debtors were unionized construction contractors. Aside from the claims of RBC as secured creditor there were debts owing to Canada Revenue Agency, lien claims, set-off claims, fraud allegations, and claims by two different unions.

Along the way, the receiver sought and obtained court approval for its activities and fees, and the fees of its legal counsel, on notice to everyone on the service list, including Canada Revenue Agency (CRA) and the unions.

In August 2015, the receiver brought a motion for court approval of the sale of real property owned by one of the debtors and authorization to distribute funds to creditors, including RBC. At that point,

[1] 2015 ONSC 5561

one of the unions came forward opposing the proposed distribution of funds and seeking a "super-priority" claim in the amount of approximately $1.5 million over all of the companies in receivership. Most significantly, the union claimed a priority over the receiver itself and sought to claw back funds that had already been distributed under prior court approvals.

In doing so, the union relied upon sections 81.3, 81.4, 81.5 and 81.6 of the Bankruptcy and Insolvency Act (BIA) and the provisions in the model order which subordinate the Receiver's charge to claims under sections 81.4 and 81.6 of the Act.[2]

As a result of the union's priority claims, the receivership virtually ground to a halt pending a determination of the issues raised by the union. In the end, the union's claims were dismissed. Justice Newbould of the Ontario Superior Court of Justice relied upon the principles of laches, estoppel and collateral attack to deny relief to the union. He noted that it would be extremely unfair to the receiver and its counsel, who had continued to act without any suggestion that their fees and disbursements would not be paid to now have what they had received taken back and to not be paid for the work done by them since the last order approving their fees and disbursements.

He also held that the union's claims were in any event subordinate to the interests of CRA, which was not objecting to the Receiver's fees. However, the issues raised in this case highlight the danger to court-appointed receivers of clauses in the model order subordinating the Receiver's charge to other interests.

The Ontario model receivership order was amended to subordinate the receiver's charge to claims under sections 81.4 and 81.6 of the BIA after the Wage Earner Protection Program Act and related amendments to the BIA came into force in 2008. The rationale for doing so was simple. Section 81.4 provides security for unpaid wages. Section 81.4(5) states that the security "ranks above every other claim, right, charge or security against the person's current assets — regardless of when that other claim, right, charge or security arose — except rights under sections 81.1 and 81.2." Similarly, section 81.6 provides priority for unpaid amounts in respect of prescribed pension plans. Section 81.3 and 81.5 are comparable provisions that apply in the case of a bankruptcy.

At the time, the thinking was that potential employee claims were limited to $2,000 per employee and receivers and trustees could readily take into account this potential liability in deciding whether to accept an appointment. However, there are two significant caveats. First, these priorities rank behind CRA claims for source deductions, which are not so readily quantifiable. Second, claims under prescribed pension plans are also not readily quantifiable. In Galmar, the union was asserting a pension claim in excess of $1 million.

Although CRA has always taken the position that its claim for source deductions ranks ahead of WEPPA (employee) claims, Galmar appears to be the first case that has judicially recognized CRA's priority. Usually, this is not an issue because WEPPA claims and source deduction claims both affect the same pocket. Here, instead, the contest was between the union and CRA.

The analysis starts with section 227(4) of the *Income Tax Act*, pursuant to which

[2] See paragraphs 16, 17 and 20 of the model order

persons who have withheld employee source deductions but have not remitted the deductions to CRA are deemed to hold those source deductions in trust for the Crown. The Crown has a super-priority claim for source deductions, ranking ahead of all other claims. This priority is preserved on bankruptcy pursuant to sections 67(3) and 81.3(4) of the BIA. A similar provision is found in section 81.5(4) of the BIA. However, there is no such provision found in sections 81.4 and 81.6 of the BIA, which apply in the context of a receivership.

The union contended that the provisions of the BIA dealing with receivership, not bankruptcy, should apply to Galmar and that the difference in the two sets of sections indicated that the CRA deemed trust does not trump the union's superpriority in a receivership. Mr. Justice's Newbould disagreed. He accepted CRA's position that the fact that section 67(3) has not been exempted from the employees' priority claim under sections 81.4 and 81.6 of the BIA can be explained because the priority of CRA under section 67(3) of the BIA applies by its terms to a bankruptcy and not to a receivership. There was thus no need for Parliament to exclude the section 67(3) priority of CRA in sections 81.4 and 81.6 dealing with employers in receivership.

Mr. Justice Newbould found that this does not mean that the priority of CRA under subsections 227(4) and (4.1) of the Income Tax Act does not survive. Under those sections, property of the person who made the withholdings to the extent of the amount deemed to be held in trust is deemed to form no part of the estate or property of such person and the Crown has a beneficial ownership in those withholdings.

This conclusion brings to light the anomaly in the Ontario model receivership order. There is nothing in the model order automatically subordinating the receiver's charge to the Crown's super-priority claim for source deductions. It is generally recognized that the receiver's charge can take priority over source deductions. If this were not the case, then receivers would be exposing themselves to indeterminate prior claims for source deductions.

While CRA might take the position that it has priority notwithstanding the receiver's charge, the practical reality is that CRA recognizes that court-appointed receivers need protection for their fees and those of their counsel. CRA benefits from the work of court-appointed receivers. This is illustrated by the Galmar case, where CRA did not contest the Receiver's priority for its fees.

So why is there a carve-out in the model order receiver's charge for claims under sections 81.4 and 81.6 of the BIA, when these claims rank behind the Crown super-priority for source deductions, which in turn is trumped by the receiver's charge? This is illogical. WEPPA imposes a significant burden on receivers and they deserve to be paid for their work. Furthermore, as discussed above, the potential liability for pension claims may be significant.

This potential liability in Galmar was exacerbated by the fact that the union was claiming priority over interests in land, including RBC's prior registered mortgage. This priority was based on the fact that sections 81.5 and 81.6 apply to all the debtor's assets, not just current assets. If this argument had been successful, the union's pension claims would have reached even further than the Crown's super-priority source deductions claim. This would have been all the more extraordinary because, unlike the case with CRA source deductions, private pension fund claims enjoy no priority over mortgages or other registered interests in land outside of a bankruptcy or receivership.

This raised an interesting constitutional question. It was unnecessary for Justice Newbould to decide this issue due to the specific facts of the case.

Ultimately, Galmar was a fact-based decision. But the lessons from Galmar run deeper. In any case where there are unions, pension plans, significant potential employee-related claims it would be wise to consider modifying the template order in use in each province to seek priority for the receiver's fees, on notice to affected stakeholders. It would also be wise for the receiver in such a situation to seek regular approval for its activities and fees, on notice to all interested stakeholders, to avoid an unpleasant surprise at the end of an assignment. RS

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