

NOTE

BANKRUPTCY: PROPERTY OF THE BANKRUPT: TRUST PROPERTY: STATUTORY TRUST OF VACATION PAY CREATING TRUST CLAIM UNDER SECTION 47(a) OF THE BANKRUPTCY ACT: *Re Phoenix Paper Products Ltd.*, 44 O.R. (2d) 225, 48 C.B.R. (N.S.) 113 (C.A. 1983).

In a recent decision, *Re Phoenix Paper Products Ltd.*,¹ the Ontario Court of Appeal has held that a trust of vacation pay deemed by the Employment Standards Act² is a valid trust for the purposes of subsection 47(a) of the Bankruptcy Act.³ Mr. Justice Tarnopolsky ruled (Howland C.J.O. and Brooke J.A. concurring) that vacation pay is not part of the property of the bankrupt vesting in the trustee in bankruptcy. It is therefore not subject to section 107 of the Bankruptcy Act, which, in setting out the scheme of distribution of the property of the bankrupt, assigns a specific priority to "wages, salaries, commissions or compensation"⁴ of an employee. While the decision resolves in Ontario, for the time being at least, the issue of whether provincial statutory trusts are enforceable in bankruptcy, it provides a facile and unconvincing analysis of the more important underlying issue: the continuing conflict between the priorities set out by the Bankruptcy Act and preferences deemed by other legislation, federal and provincial.

In the 1949 revision of the Bankruptcy Act, Parliament established a system of priorities for claims of employees and the Crown, among others.⁵ This scheme of distribution, however, was subject to the rights of secured creditors and did not apply to property held by the bankrupt in trust for others.⁶ Taking advantage of these two opportunities to obtain a preference not granted in the Act, federal and provincial legislators deemed that taxes and other moneys owed to the Crown, or in certain cases, to employees, would constitute either a first lien, charge or privilege on the debtor's property, thus making the Crown or employees secured creditors;⁷ or a trust,⁸ preventing the money owed from vesting in the trustee in bankruptcy. In section 15 of the Employment Standards

¹ 44 O.R. (2d) 225, 48 C.B.R. (N.S.) 113 (C.A. 1983).

² R.S.O. 1980, c. 137, s. 15.

³ R.S.C. 1970, c. B-3.

⁴ Para. 107(1)(d).

⁵ S.C. 1949 (2d sess.), c. 7, s. 95 (replaced by R.S.C. 1970, c. B-3, s. 107).

⁶ Sub. 39(a) (replaced by sub. 47(a)).

⁷ See, e.g., Employment Standards Act, S.B.C. 1980, c. 10, s. 15; Workers Compensation Act, R.S.B.C. 1979, c. 437, s. 52; The Workmen's Compensation Act, R.S.N. 1970, c. 403, sub. 88(2); Workers' Compensation Act, R.S.N.B. 1973, c. W-13, sub. 72(2) (as amended by S.N.B. 1975, c. 92, s. 8); Labour Standards Code, S.N.S. 1972, c. 10, s. 84; Workmen's Compensation Act, R.S.N.S. 1967, c. 343, s. 125; Workmen's Compensation Act, R.S.O. 1980, c. 539, sub. 120(3).

⁸ See, e.g., Canada Pension Plan, R.S.C. 1970, c. C-5, subs. 24(3), (4); Income Tax Act, S.C. 1970-71-72, c. 63, subs. 227(4), (5); Unemployment Insurance Act, 1971, S.C. 1970-71-72, c. 48, sub. 71(3); Social Service Tax Act, R.S.B.C. 1979, c. 388, sub. 18(1); Labour Standards Code, S.N.S. 1972, c. 10, s. 34; The Labour Standards Act, R.S.S., c. L-1, sub. 56(1) (as amended by S.S. 1980-81, c. 63, s. 5).

Act, legislators took no chances and deemed that the money owed was both a trust and a lien:

Every employer shall be deemed to hold vacation pay accruing due to an employee in trust for the employee whether or not the amount therefor has in fact been kept separate and apart by the employer and the vacation pay becomes a lien and charge upon the assets of the employer that in the ordinary course of business would be entered in books of account whether so entered or not.⁹

The liens, charges, privileges and trusts provided by federal and provincial legislation appear, in some cases, to be in direct conflict with the scheme of distribution in the Bankruptcy Act. Thus, while claims of the Crown not specifically mentioned in section 107 are given tenth and last priority,¹⁰ the Canada Pension Plan, for instance, provides that employee contributions under the Plan constitute a trust, with the result that they are not subject to the section at all and are effectively ranked above claims listed in that section.¹¹ Similarly, Workmen's Compensation Acts in various provinces create liens,¹² and the federal Unemployment Insurance Act, 1971¹³ and Income Tax Act¹⁴ create trusts although under section 107 of the Bankruptcy Act claims under these Acts are given eighth priority.¹⁵ Employees enjoy fourth priority, but their recovery is limited to the lesser of three months' pay or five hundred dollars;¹⁶ their position is therefore much improved if they can claim the whole of their vacation pay as trust money under subsection 47(a).

While conflicts between the Bankruptcy Act and other federal statutes can be resolved by interpretation,¹⁷ it was argued in *Re Phoenix Paper Products Ltd.* that provincial statutes which provide for priorities in insolvency conflicting with those in the Bankruptcy Act are inoperative to the extent of the conflict because of federal paramountcy under the Bankruptcy and Insolvency power.¹⁸ This argument was successful in a recent Supreme Court decision, *Deputy Minister of Revenue v. Rainville*,¹⁹ where Mr. Justice Pigeon held that a Quebec taxing statute giving the Crown a first privilege did not constitute the Crown a secured creditor, despite the definition of secured creditor in the Bankruptcy Act as "a person holding a . . . privilege . . . against the

⁹ R.S.O. 1980, c. 137.

¹⁰ Para. 107(1)(j).

¹¹ R.S.C. 1970, c. C-5, subs. 24 (3), (4).

¹² See note 7 *supra*.

¹³ S.C. 1970-71-72, c. 48, sub. 71(3) (as amended by S.C. 1974-75-76, c. 80, s. 26).

¹⁴ Income Tax Act, S.C. 1970-71-72, c. 63, subs. 227(4), (5).

¹⁵ Para. 107(1)(h).

¹⁶ Para. 107(1)(d).

¹⁷ P. HOGG, CONSTITUTIONAL LAW OF CANADA 101 (1977); MAXWELL ON THE INTERPRETATION OF STATUTES 191-93 (12th ed. P. St. J. Langan 1969).

¹⁸ *Supra* note 1, at 228, 48 C.B.R. (N.S.) at 116.

¹⁹ [1980] 1 S.C.R. 35, 105 D.L.R. (3d) 270 (1979).

property of the debtor’’²⁰ and despite the fact that the Crown had registered the privilege against the property before bankruptcy. Six of the seven justices agreed with the following interpretation of paragraph 107(1)(j):

It is abundantly clear that [paragraph 107(1)(j)] was intended to put on an equal footing all claims by Her Majesty in right of Canada or of a Province except in cases where it was provided otherwise, namely, para. (c), the levy, and para. (h), workmen’s compensation or unemployment insurance assessments and withholdings for income tax. . . . ‘[N]otwithstanding any statutory preference to the contrary’. . . . [Parliament] therefore cannot have intended to allow provincial statutes to confer any higher priority.²¹

Rainville was considered by some courts to have decided the matter. In Nova Scotia, the Court of Appeal found *Rainville* “definitive in disposing of the issues’’²² raised by claims under a lien and a trust, both created by provincial legislation:

Mr. Justice Pigeon made it abundantly clear that priorities of provincial claims must be determined in accordance with s. 107(1) of the *Bankruptcy Act* notwithstanding any statutory preference to the contrary. . . . Claims for wages are governed by s. 107(1)(d). With deference, it is not open to the province to provide any higher or more extensive priority for wages in view of the express provisions contained in that clause.²³

This decision, together with *Rainville*, was relied on as authority in the British Columbia judgment, *Re Racknagel*, dismissing an appeal from the disallowance of a claim for wages under a provincial statute.²⁴ In another case²⁵ the Supreme Court of British Columbia, dismissing claims under *federal* statutory trusts, relied on *Rainville* and emphasized “the overriding intention of the Bankruptcy Act.’’²⁶ In an earlier British Columbia case,²⁷ however, *Rainville* was held not to apply to a statutory trust. The conflict also continues in other provinces where courts have distinguished *Rainville* as applying only to Crown claims, but not to

²⁰ S. 2.

²¹ *Supra* note 19, at 44, 105 D.L.R. (3d) at 277.

²² *Re Black Forest Restaurant Ltd.*, 47 N.S.R. (2d) 446, at 452, 126 D.L.R. (3d) 417, at 420 (C.A. 1981), *aff’d* 47 N.S.R. (2d) 454, 121 D.L.R. (3d) 435 (S.C. Bank. 1981). For comment on the significance of *Rainville*, see Marantz, *Current Trends in Canadian Bankruptcy Law*, in CORPORATE LAW IN THE 80s, SPECIAL LECTURES 659, at 668 (Law Society of Upper Canada ed. 1982), and Meeks, *Statutory Trusts*, in NEW DEVELOPMENTS IN COMMERCIAL LENDING, MEREDITH MEMORIAL LECTURES 113 (1981).

²³ *Id.* at 454, 126 D.L.R. (3d) at 422.

²⁴ 42 C.B.R. (N.S.) 135, at 139 (B.C.S.C. 1982).

²⁵ *Coopers & Lybrand Ltd. v. The Queen*, 32 B.C.L.R. 100, 39 C.B.R. (N.S.) 247 (S.C. 1981).

²⁶ *Id.* at 105-06, 39 C.B.R. (N.S.) at 253.

²⁷ *Re Reimer*, 27 B.C.L.R. 149 (S.C. 1980).

employee claims under provincial deemed trusts,²⁸ or as not applying to statutory trusts at all.²⁹ In Ontario, the Supreme Court in Bankruptcy took the view in *Re Alduco Mechanical Contractors Ltd.*,³⁰ that the effect of *Rainville* should be limited to statutory liens and charges, and that provincial statutory trusts were not in conflict with section 107 since they fell under subsection 47(a). This view was followed at trial in *Re Phoenix Paper Products Ltd.*³¹

In that case, the Director of Employment Standards and the Canadian Paper Workers Union, representing the employees of the bankrupt, claimed vacation pay provided for the employees under their collective agreement. The termination of employment occurred and the vacation pay was due before the trustee in bankruptcy was appointed. Initially the Director and the Union claimed priority under paragraph 107(1)(d) of the Bankruptcy Act, but at trial they argued the employees' claim as beneficiaries of the trust created by section 15 of the Employment Standards Act. Mr. Justice Gray considered the fact that *Rainville* had been held to be definitive in courts in other provinces but preferred the view in *Re Alduco*. On appeal, Tarnopolsky J.A. agreed that "while the *Rainville* case eliminates provincial statutory liens in favour of the Crown, it does not affect statutory trusts giving a privileged position."³² In his view, the statement in *Rainville* that Parliament could not have intended provincial statutes to confer any higher priority than that conferred by the Bankruptcy Act went "no further than to reaffirm federal paramountcy."³³

To decide whether the vacation pay claimed was governed by the priorities in section 107 or was trust money not vested in the trustee, Tarnopolsky J.A. found it necessary to determine whether a Supreme Court decision of 1962 had "been overridden [*sic*] by the *Rainville* case. . . ."³⁴ In *John M.M. Troup Ltd. v. Royal Bank of Canada*, Judson J. held that "[a]s to bankruptcy, the creation of the trust by s. 3(1) [of The Mechanics' Lien Act]³⁵ does affect the amount of property divisible among the creditors but so does any other trust validly created."³⁶ *Troup*, as Tarnopolsky J.A. acknowledged, was a banking case; bankruptcy was not considered since the alleged breach of trust took

²⁸ *R. v. Coopers & Lybrand Ltd.*, [1983] 2 W.W.R. 533, 143 D.L.R. (3d) 154 (Q.B. 1982); *Re Alduco Mechanical Contractors Ltd.*, 35 O.R. (2d) 445, 134 D.L.R. (3d) 104 (S.C. Bank. 1982); *Re Phoenix Paper Products Ltd.*, 44 C.B.R. (N.S.) 274 (Ont. S.C. Bank. 1983).

²⁹ *R. v. Coopers & Lybrand Ltd.*, *id.*; *Re Alduco Mechanical Contractors Ltd.*, *id.*; *Re Reimer*, *supra* note 27.

³⁰ *Id.*

³¹ *Id.*

³² *Supra* note 1, at 238, 48 C.B.R. (N.S.) at 127.

³³ *Id.* at 230, 48 C.B.R. (N.S.) at 119.

³⁴ *Id.* at 231, 48 C.B.R. (N.S.) at 119.

³⁵ R.S.O. 1960, c. 233, sub. 3(1) (*replaced by* Construction Lien Act, 1983, S.O. 1983, c. 6, sub. 8(1)).

³⁶ [1962] S.C.R. 487, at 494, 34 D.L.R. (2d) 556, at 572.

place well before bankruptcy, when the bank received the funds impressed with the trust and applied them to reduce the contractor's indebtedness to the bank. Later the contractor could not meet his obligations to his subcontractors, who sued the bank for breach of trust. Six of the seven judges held that the bank was not liable because it had received the funds in good faith and without notice of the trust. The issue of the constitutionality of the trust was *obiter*. Abbott and Taschereau JJ. concurred with Judson J. while Cartwright J. also concurred but did "not find it necessary to express an opinion on the constitutional points."³⁷ Martland and Ritchie JJ. concurred with both Judson and Cartwright JJ.; since Judson and Cartwright JJ. did not agree on the relevance of the constitutional argument, presumably Martland and Ritchie JJ. did not consider constitutionality an issue. The "principal majority judgment"³⁸ to which Mr. Justice Tarnopolsky refers represents, on the constitutional issue, a "majority" of three of the seven judges; the statement which he finds is not overridden by the decision in *Rainville* is one sentence at the end of Judson J.'s judgment, an *obiter* postscript.

It is questionable whether the weight given to *Troup* in *Re Phoenix Paper Products Ltd.* can be justified in light of the strong statement in *Rainville*, which is a bankruptcy case where paramountcy was an issue.³⁹ Indeed, in his conclusion Tarnopolsky J.A. goes no further than to assert that *Troup* is authority that provincial legislatures can create valid trusts.⁴⁰ This assertion does not answer the question with which he began, which was whether *Troup* has been overridden by *Rainville* to the extent that provincially deemed trusts cannot prevail against the express priorities in section 107, a question which was not considered in *Troup*.

The matter of what constitutes a validly created trust is little investigated in *Re Phoenix Paper Products Ltd.* beyond the point of finding that provinces can legislate trusts. The enforceability of a trust where the trust property never existed did not have to be considered in *Troup* because the bank had received identifiable trust property, the cheque for the holdback payments. If, however, the bankrupt has never collected or received funds, or had surplus funds to set aside according to the statutory trust, and if at the time of the bankruptcy there is no money in the bankrupt's estate to cover the claim, there is no "property held in trust by the bankrupt." Finding, in these circumstances, that the trust is

³⁷ *Id.* at 504, 34 D.L.R. (2d) at 566.

³⁸ *Supra* note 1, at 230, 48 C.B.R. (N.S.) at 119.

³⁹ See generally Feldthusen, *Statutory Liens: Secured Claim or Preferred Claim*, 37 C.B.R. (N.S.) 163 (1981). Professor Feldthusen comments that Pigeon J. does not address the constitutional issue squarely but assumes Parliament's intention to override provincial law.

⁴⁰ *Supra* note 1, at 238, 48 C.B.R. (N.S.) at 127-28.

valid is giving the Crown a preference in the distribution of the bankrupt's assets that conflicts with the Bankruptcy Act.⁴¹

To discover whether in case law *Troup* has been overridden by *Rainville*, Tarnopolsky J.A. examined two conflicting lines of cases. One decision in Nova Scotia and three in British Columbia have taken the view that *Rainville* applies to statutory trusts as well as liens.⁴² In opposition to these are listed seven cases which hold that deemed trusts are valid under subsection 47(a) and are not part of the property of the bankrupt. Of those, three were decided before *Rainville*;⁴³ of the remaining four, two dealt with federal trusts,⁴⁴ and one, a decision in British Columbia, has not been followed in British Columbia;⁴⁵ the remaining authority is *Re Alduco*.⁴⁶

In *Re Alduco*, Steele J. followed the reasoning in *Re Dairy Maid Chocolates Ltd.*,⁴⁷ an Ontario decision rendered eight years before

⁴¹ See REPORT OF THE STUDY COMMITTEE ON BANKRUPTCY AND INSOLVENCY LEGISLATION 112-13 (R. Tassé Chairman 1970). The Committee objects to deemed trusts where at the time of bankruptcy there is not sufficient money in the estate to satisfy the claim:

[I]n [the] case of the bankruptcy of an employer, the law presumes that the money, which was supposed to have been set aside, but was not, was in fact kept separate and apart from the employer's own moneys, notwithstanding the fact the employer had no cash or money on deposit at the time of his bankruptcy. . . . Thus, the law grants to government a privilege not available to other creditors whereby not only moneys, but all the assets of the employer, are, in case of bankruptcy, considered as held in trust for the government to the extent of the deductions. This privilege invites abuses. It permits the employer, on the verge of bankruptcy, to use the moneys held back from his employees to pay his suppliers. . . . In so doing, he may hope to avoid or postpone ultimate financial disaster. Unfortunately, last ditch attempts, in such circumstances, usually result in magnifying the proportions of the failure. In addition, the amount deemed to be held in trust amounts to a priority over the other creditors.

See generally Baird, Comment, 17 C.B.R. (N.S.) 273 (1972); Baird, *Statutory Trusts Liens — Priority Over Claims of Secured Creditors*, 25 C.B.R. (N.S.) 261 (1978); J. Berman, Order of Priorities in the Scheme of Distribution in Estates Under the Bankruptcy Act, (unpublished Working Notes, Bankruptcy Seminar, Toronto, 30 Nov. 1973); Catzman, *Employment Claims in Bankruptcy*, in EMPLOYMENT LAW, SPECIAL LECTURES 213 (Law Society of Upper Canada ed. 1976).

⁴² *Re Black Forest Restaurant Ltd.*, *supra* note 22; *Re Racknagel*, *supra* note 24; *Kinross Mtge. Corp. v. Bushell*, 31 B.C.L.R. 382, 127 D.L.R. (3d) 740 (C.A. 1981); *Coopers & Lybrand Ltd. v. The Queen*, *supra* note 25.

⁴³ *Re KRA Restaurants Ltd. & Toronto Dominion Bank*, 74 D.L.R. (3d) 272 (N.S.S.C. Bank. 1977); *Re Dairy Maid Chocolates Ltd.*, [1973] 1 O.R. 603, 31 D.L.R. (3d) 699 (S.C. Bank. 1972); *Re Deslauriers Constr. Products Ltd.*, [1970] 3 O.R. 599, 13 D.L.R. (3d) 551 (C.A.).

⁴⁴ *Re Kraemer*, 43 C.B.R. (N.S.) 232 (Ont. S.C. Bank. 1982); *Dauphin Plains Credit Union Ltd. v. Xyloid Indus. Ltd.*, [1980] 1 S.C.R. 1182, 108 D.L.R. (3d) 257.

⁴⁵ *Re Reimer*, *supra* note 27, *not foll'd in* *Coopers & Lybrand Ltd. v. The Queen*, *supra* note 25, and *Re Racknagel*, *supra* note 24.

⁴⁶ *Supra* note 28.

⁴⁷ *Supra* note 43.

Rainville and involving the predecessor of section 15 of the Employment Standards Act.⁴⁸ That section provided that vacation pay would be deemed to be held in trust and that the amount would be "a charge upon the assets of the employer . . . in his hands or the hands of a trustee and [would] have priority over all other claims." Mr. Justice Houlden found that the trust created was valid if the part after "in his hands" was severed because in insolvency "there was no power in the provincial Legislature to give priority over other claims or to create a trust on property in the hands of a trustee."⁴⁹ He decided that the trust was not in conflict with the Bankruptcy Act because "the charge became effective not on bankruptcy, but on termination of employment for any cause or by operation of law."⁵⁰ Mr. Justice Tarnopolsky approved the reasoning in *Re Dairy Maid Chocolates Ltd.* and relied on it in his conclusion.⁵¹

He also relied on a recent decision of the Supreme Court of Canada as authority for the proposition that a deemed trust is enforceable in bankruptcy. In *Dauphin Plains Credit Union Ltd. v. Xyloid Industries Ltd.*,⁵² a case heard eighteen days after the decision in *Rainville* was handed down, Pigeon J. decided that certain federal statutory trusts were effective trusts under subsection 47(a). Because of the proximity of the two decisions, Tarnopolsky J.A. concluded that "*Dauphin Plains* could not have been considered in conflict with *Rainville* . . ."⁵³

In *Dauphin Plains* the Court considered three federal trusts, created by the Income Tax Act,⁵⁴ the Canada Pension Plan⁵⁵ and the Unemployment Insurance Act, 1971.⁵⁶ The Minister of National Revenue claimed the funds deducted under those Acts from wages paid to employees by the receiver in a contractual receivership and by the employer before the receivership occurred. In his decision, Pigeon J. found that contractual receivership was included in the meaning of "liquidation" as used in the three Acts and that liquidation was equivalent to bankruptcy.⁵⁷ The Court held that because the receiver had ample funds when he made the payments, the amounts he deducted were true deductions and were held in trust for the tax collector.⁵⁸ The claims under all three Acts for trust moneys deducted by the receiver were successful.

In considering the claims for deductions made by the employer prior to the receivership, however, Mr. Justice Pigeon came to another conclusion. First, he held that the deductions made by the employer were

⁴⁸ The Employment Standards Act, R.S.O. 1970, c. 147, sub. 8(2).

⁴⁹ *Supra* note 43, at 605, 31 D.L.R. (3d) at 701.

⁵⁰ *Id.*

⁵¹ *Supra* note 1, at 239, 48 C.B.R. (N.S.) at 128.

⁵² *Supra* note 44.

⁵³ *Supra* note 1, at 235, 48 C.B.R. (N.S.) at 123.

⁵⁴ S.C. 1970-71-72, c. 63, sub. 227(4).

⁵⁵ R.S.C. 1970, c. C-5, subs. 24(3), (4).

⁵⁶ S.C. 1970-71-72, c. 48, subs. 71(2), (3).

⁵⁷ *Supra* note 44, at 1201-02, 108 D.L.R. (3d) at 268-70.

⁵⁸ *Id.* at 1195-96, 108 D.L.R. (3d) at 267.

not true deductions because the employer had no surplus after paying the net wages. Secondly, he found the reasoning in *Re Deslauriers Construction Products Ltd.*,⁵⁹ an Ontario case which also considered the Canada Pension Plan and the Unemployment Insurance Act, 1971, to be "wholly persuasive".⁶⁰ deemed trusts will succeed in bankruptcy only if the funds really existed, in the sense that they were collected or set aside, or if they were deemed by the statute to have been set aside, as was the case with the Canada Pension Plan and the Unemployment Insurance Act, 1971. The claims under those two trusts were successful; the claim under the Income Tax Act was not because the trust funds had neither existed nor been deemed to exist.

In the light of this analysis of the enforceability of deemed trusts, Mr. Justice Houlden's reasoning in *Re Dairy Maid Chocolates Ltd.*⁶¹ is no longer relevant. The critical question is not why or when the charge became effective but whether, when it became effective, the trust money in fact existed or was deemed to exist. In the predecessor of section 15, trust moneys were not deemed to be set aside; therefore, using the test in *Dauphin Plains*, the trust would have been enforceable only if, at the time it became effective, there had been surplus funds in the hands of the employer. Section 15 does deem the trust fund to be set aside and leaves the question whether trust funds deemed by provincial legislation to exist, but which in fact never existed, constitute property held in trust by the bankrupt under subsection 47(a) of the Bankruptcy Act, or a "statutory preference" in conflict with section 107.

Counsel for the trustee in bankruptcy in *Re Phoenix Paper Products Ltd.* argued that "*Deslauriers* and *Dauphin Plains* were concerned with federal statutory trusts and that Parliament, since it has legislative jurisdiction with respect to bankruptcy and insolvency, could change the order of priorities."⁶² The Court of Appeal held that since Pigeon J. "made no distinction between federal and provincial trusts,"⁶³ provincial deemed trusts are also enforceable in bankruptcy. *Rainville* is therefore to be restricted to provincial legislation creating liens and charges, and *Dauphin Plains* is to be extended to include provincial trusts.

Surely a more reasonable reconciliation of *Dauphin Plains* and *Rainville* is that *Rainville* deals with provincial statutory preferences and *Dauphin Plains* with federal statutory preferences. Provincial statutory preferences are inoperative when they conflict with the priorities of federal insolvency legislation; federal legislation can alter the priorities because of federal jurisdiction with respect to insolvency and bankruptcy. Pigeon J. made no distinction between provincial and federal trusts in

⁵⁹ *Supra* note 43.

⁶⁰ *Supra* note 44, at 1198, 108 D.L.R. (3d) at 267.

⁶¹ *Supra* note 43.

⁶² *Supra* note 1, at 235, 48 C.B.R. (N.S.) at 124.

⁶³ *Id.*

Dauphin Plains because (a), provincial trusts were not in issue, and (b), he had dealt with provincial statutory preferences in *Rainville*.

In *Re Alduco*, Steele J. distinguished *Rainville* not only on the basis that it applied to statutory liens and charges, but also on the ground that the trust set up by section 15 of the Employment Standards Act is not in favour of the Crown but of employees.⁶⁴ Gray J. adopted Mr. Justice Steele's reasoning on this point in the trial decision.⁶⁵ In the appeal judgment the distinction is not made. Tarnopolsky J.A.'s decision applies, therefore, to all provincial statutory trusts, whether in favour of the Crown or others.

CONCLUSION

In the judgment Mr. Justice Tarnopolsky provides a concise summary of his conclusions:

- (1) The provincial Legislatures can create valid trusts by legislation: the *Troup* case. . . .
- (2) A "deemed" trust created by legislation has been held to be enforceable in bankruptcy: the *Dauphin Plains* case.
- (3) Section 15 of the *Employment Standards Act* creates a valid "deemed" trust.
- (4) By s. 47(a) of the *Bankruptcy Act*, property held in trust does not form part of the property of the bankrupt.
- (5) Therefore, Houlden J. in the *Dairy Maid Chocolates* case, Steele J. in *Re Alduco*, and Gray J. in this case were correct in concluding that s. 15 of the *Employment Standards Act* creates a valid "deemed" trust claim within the meaning of s. 47(a) of the *Bankruptcy Act* and, as such, does not form part of the "property of a bankrupt divisible among his creditors".⁶⁶

If these conclusions are correct, then it only remains for provincial legislators to deem, under their Property and Civil Rights power, that wages, salaries, commissions, arrears of rent to landlords, and all debts to the provincial Crown or to anyone they choose are trust property. Thus, while remaining consistent with federal legislation, without conflict or contradiction, provincial legislation can set its own priorities in bankruptcy and insolvency, and render federal legislation ineffective. Surely the results demonstrate that there is a conflict in substance if not in form. Mr. Justice Tarnopolsky's interpretation of *Rainville* as going "no further than to reaffirm federal paramountcy"⁶⁷ fails to explain why the provincial government was not allowed to claim as a secured creditor, when by virtue of the provincial legislation it had brought itself within the definition of secured creditor in the federal legislation. The

⁶⁴ *Supra* note 28, at 448, 134 D.L.R. (3d) at 108.

⁶⁵ *Id.*

⁶⁶ *Supra* note 1, at 238-39, 48 C.B.R. (N.S.) at 127-28.

⁶⁷ *Supra* note 33 and accompanying text.

explanation may be that a privilege deemed by provincial legislators cannot transform a preferred creditor into a secured creditor for the purposes of section 107 of the Bankruptcy Act. Nor, it may be argued, can a provincial deemed trust transform a liability into trust property if the result is to circumvent section 107.

While provincial legislation can create valid trusts where no trust property has been received or set aside, these trusts are "statutory preferences" in the context of paragraph 107(1)(j) of the Bankruptcy Act and as such have been held by Pigeon J. to be "contrary to the intent of Parliament."⁶⁸ Parliament itself can alter the priorities of federal bankruptcy legislation, as the Supreme Court decided in *Dauphin Plains*, but to suggest that provincial legislation has the same power as federal legislation to circumvent section 107 is to ignore the statement in *Rainville* that section 107 is "federal law intended to override provincial law throughout Canada."⁶⁹

Re Phoenix Paper Products Ltd., besides confirming the position the Ontario courts have taken with respect to the enforceability of provincial statutory trusts in bankruptcy, also confirms another trend: the Bankruptcy Act and the *Rainville* decision are being interpreted in different ways in different provinces. In a recent decision in Saskatchewan, the Court of Queen's Bench applied the reasoning in *Re Dairy Maid Chocolates Ltd.* and distinguished *Rainville*.⁷⁰ In Nova Scotia the Court of Appeal has decided that *Rainville* applies to provincial statutory trusts as well as liens.⁷¹ The courts in British Columbia take differing views of provincial trusts.⁷²

As Mr. Justice Tarnopolsky points out, the issue could be resolved by legislation:

There is no doubt that Parliament can amend s. 47 of the *Bankruptcy Act* so as to vary the situation with respect to exemption of trusts from the property of the bankrupt to be distributed according to s. 107 of the Act, whether by excluding all trusts, statutory or otherwise, or only the former or only certain ones of the former.⁷³

Indeed, the proposed bankruptcy legislation, if it were passed, would settle the matter.⁷⁴ In view of the delays which have already occurred in the attempt to reform the Bankruptcy Act, however, the more realistic hope is that, as soon as possible, the Supreme Court of Canada will

⁶⁸ *Rainville*, *supra* note 19, at 46, 105 D.L.R. (3d) at 279.

⁶⁹ *Id.* at 44, 105 D.L.R. (3d) at 277.

⁷⁰ *R. v. Coopers & Lybrand Ltd.*, *supra* note 28.

⁷¹ *Re Black Forest Restaurant Ltd.*, *supra* note 22.

⁷² See *Re Reimer*, *supra* note 27; *Coopers & Lybrand Ltd. v. The Queen*, *supra* note 25; *Re Racknagel*, *supra* note 24.

⁷³ *Supra* note 1, at 230, 48 C.B.R. (N.S.) at 119. See also WAGE PROTECTION IN MATTERS OF BANKRUPTCY AND INSOLVENCY 26 (R. Landry Chairman 1981).

⁷⁴ Insolvency Act, Bill C-17, 32nd Parl., 2d sess. 1983-84, part 265(4)(i), subcl. 270(2) (1st reading, 31 Jan. 1984).

resolve the uncertainty and inconsistent interpretations by dealing specifically with the enforceability of provincial statutory trusts in bankruptcy.

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