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CONSTRUCTION LIEN ACT

by
Leonard Ricchetti
& Gina Rogakos
*Members of the McMillan
Construction Law Group*

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THE CONSTRUCTION LIEN ACT

The *Construction Lien Act*¹ (the “Act”) is complex. We have attempted to simplify the major lien concepts so that the reader could understand and digest them. However, the application of construction lien law and concepts to a specific set of facts by necessity requires legal advice from a lawyer familiar with and experienced in the application of the Act, as mistake or failure to comply with the Act is usually fatal.

I. OVERVIEW OF THE ACT

Construction Lien legislation was established to provide some financial protection for those persons who supplied services or materials to a construction project. In many cases, those persons have not contracted directly with the owner but are hired by a contractor or subcontractor. Where persons perform work for an improvement on lands but do not get paid for their services or materials, the legislation provides them remedies in the form of construction liens, mandatory holdbacks and statutory trusts.

Because the protections of the Act are entirely statutory and create rights and remedies that impact third parties, the judicial approach to interpretation of these statutory rights is important. Courts have acknowledged that the Act provides individuals supplying services or materials to a construction project remedies they would not otherwise have and a priority over other creditors. Accordingly, the Act is given a strict interpretation in determining who is entitled to its remedial protections, but once rights are found to apply to the creditor, the Act is liberally construed.²

The Act is mandatory, and parties cannot contract out of it, or the remedial protections it provides.³ If a contract does not conform with the Act, it is deemed to be amended in so far as is necessary to bring it into conformance with the Act.⁴

The Act contains a curative provision (Section 6), which gives the court a limited discretion to avoid the consequences of failing to comply strictly with certain lien sections. However, the case law makes it very difficult to predict what a court will decide in any particular circumstance. If anything, unless the irregularity is found to be “minor ” or just a “technicality” with no prejudice to the other parties, reliance on this curative section to maintain a lien is questionable.

The Act creates three types of protection to parties who supply services or materials to an improvement under the Act:

1. **Construction Liens;**
2. **Holdbacks; and**
3. **Construction Lien Trusts**

The details of each type of protection are discussed below along with applicable related concepts.

II. CONSTRUCTION LIENS

(a) When and Where Construction Liens Arise

Every person who supplies services or materials to an improvement for an owner, contractor or subcontractor has a lien on the owner’s interest in the premises⁵ for the price of those services or materials.

A construction lien is in essence a charge or security on the premises improved in favor of a party who has contributed to the enhancement of value to the lands. The lien is also a charge on the holdback funds, which are required to be maintained by owners, contractors and other parties in the construction pyramid.

¹ *Construction Lien Act*, R.S.O. 1990, c. C.30.

² *Clarkson Co. Ltd. v. Ace Lumber Ltd.*, [1963] S.C.R. 110.

³ *Supra* note 1, s. 4.

⁴ *Ibid.* s. 5.

⁵ Premises is defined in the Act as including “the improvement, all materials supplied to the improvement, and the land occupied by the improvement, or enjoyed therewith, or the land upon or in respect of which the improvement was done or made.” *Supra* note 1, s. 1(1) “premises”.

Therefore, there are three preliminary requirements (all of which must be met) for a party to establish entitlement to a lien:

- a) The supply of services or materials;
- b) to an improvement;
- c) for an owner, contractor or subcontractor.

(i) *The Supply of Services or Materials*

Supply of services means any work done or services performed upon or in respect of an improvement, and includes:

- a) the rental of equipment with an operator; and
- b) the supply of a design, plan, drawing or specification that in itself enhances the value of the owner's interest in the land.

Supply of materials means every kind of moveable property that:

- a) becomes or is intended to become part of the improvement;
- b) used directly in the making of the improvement; or
- c) used to facilitate the making of the improvement.

There are a number of obvious issues that arise solely from these important definitions.

With respect to the supply of services, while the definition appears to be broad it does have a number of limitations. The following are examples of certain supplies that would not be covered:

- If the supply was for a project that was not an improvement (as discussed in more detail below), such as the installation of washers and dryers in a Laundromat, the supply of services would not permit the installer to lien the property.
- An architect who supplies a design or plan for an improvement that does not proceed, likely would not enjoy the benefits of a lien. The issue is whether having the design or plan in the absence of the project enhanced the value of the lands. The approved subdivision plans would qualify whereas, a house design likely would not.

The removal of "materials" from lands may or may not constitute the "supply of services", as there is conflicting law on this issue.

With respect to the supply of materials, the definition is much broader as any material that becomes part of the improvement or facilitates the making of the improvement is covered. By using the word "facilitate" it is hard to imagine many situations where the material supplier would not have a lien, provided the project was an improvement. For example, if the supply was for a project that was not an improvement – such as the supply and installation of chattels (i.e., the washers and dryers in the Laundromat) on a property there would be no lien rights available to the supplier.

This does not mean the material supplier could not protect itself through other statutory avenues such as the *Personal Property Security Act*.

(ii) *An Improvement*

An improvement means,

- a) a. any alteration, addition or repair to, or
- b) b. any construction, erection or installation on, any land, and includes the demolition or removal of any building, structure or works or part thereof, and "improved" has a corresponding meaning.⁶

⁶ *Supra* note 1, section 1(1) "improvement".

Even where actual construction may not have started on the lands, it may be possible to satisfy this requirement if the lien claimant can show that the preliminary work has been done that enhanced the value of the lands. You can imagine that there are many circumstances where work is done that enhances the value of the lands before the first shovel goes into the ground. An example would be the subdivision plans where the project doesn't go ahead. On the basic premise of the Act, there is no reason why these suppliers of services shouldn't be protected by way of a lien.

While it was intended that the definition of "improvement" be given a broad interpretation when the Attorney General's Advisory Committee on the Draft Construction Lien Act ("Committee") put forward the Act, (and has generally been so interpreted by the courts), it is important to consider whether the work performed is within the definition of "improvement". There are many cases where the courts have struggled to determine whether the project resulted in something "attaching to" or "integral to" the realty. The importance of the lien claimant's services or materials being made to an "improvement" was most recently demonstrated in *Kennedy Electric Ltd. v. Dana Canada Corporation*,⁷ where the Ontario Court of Appeal unanimously held the installation of 500,000 tons of production equipment, bolted into a 100,000 square foot factory with 3,000 mechanical and electrical bolts, was not an "improvement" under the Act and therefore the sub-contractor was not entitled to a lien under the Act.

The facts of the *Kennedy* case are somewhat unique. First, the construction of the building that would house the equipment, and the design, construction and installation of that equipment was done in two steps, at different times, pursuant to separate contracts and by different parties.

Second, the equipment, while extensive, could be completely removed from the premises and in fact, had been assembled elsewhere, tested, disassembled and delivered/reassembled at the premises.

Based on these facts, the Court concluded the machinery was not an improvement, or part of an improvement, that gave rise to lien rights. The decision was primarily based on the following principles:

- whether or not a person is entitled to a lien should be strictly construed;
- the intention of the Act was to include only building construction and building repair industries; and
- the machinery was fully portable. Accordingly, the equipment was not integral to the structure and if removed, there would be no 'improvement' to the premises.

The question that remains after *Kennedy* is whether it will be limited to machinery installed into a building that supports the business rather than the building itself, or whether the principles outlined therein will be applied to other scenarios, having more far reaching consequences.

Another potential basis for distinguishing *Kennedy* is that the Court of Appeal was bound by the trial judge's finding this was not an integrated project. There are a number of cases which discuss the concept of "integrated project". In essence, some courts have found that, even where a part of the project includes materials which may be removed (i.e., roof, HVAC), because these materials were so integrated into the building, the supplier was nevertheless entitled to a lien. Other cases have come to the opposite conclusion (i.e., water silo). It is difficult to predict what a court might conclude in any particular case and what impact the *Kennedy* decision will have on this line of case law.

(iii) For an Owner, Contractor or Subcontractor

The definition of an owner in the Act is very broad and goes well beyond just the registered owner of the lands or even the person who is ultimately paying for the improvement.

For the purposes of the Act, an owner is one who:

- a) Has an interest in the premises (which includes the improvement, materials supplied to the improvement and the land occupied by the improvement or enjoyed therewith – this important definition is dealt with later); and

⁷ *Kennedy Electric Ltd. v. Rumble Automation Inc.*, [2004] O.J. No. 5091 (C.A.).

- b) Has made a request for the improvement; and
- c) The work is being done on that person's behalf, its credit, its request, privity or consent, or its benefit.

Clearly, under this definition parties other than the registered owner of the lands may be an "owner" under the Act. The exercise of determining who is an "owner" under the Act is a fact-driven exercise for the trier of fact. Issues such as whether the party "requested" or "benefits" from the work can be difficult questions of fact given the unlimited manner in which construction projects are conceived and carried out by a variety of parties.

An example where the Act has dealt with this explicitly is in the landlord/tenant situation. Clearly a tenant has an interest in the lands and may be the party requesting the work to be done (with or without a landlord's knowledge). The landlord's ownership interest in the lands will be subject to a lien for the tenant's improvements. However, the Act specifically exempts the landlord's interest (registered owner's interest) from being liened unless the contractor gives the landlord prior written notice of the improvement to be made and the landlord fails to give written notice to the contractor that the landlord assumes no responsibility for the improvement to be made. In this way, the contractor, by giving this notice, will be able to ascertain its rights (or lack of lien rights) before it starts work on the improvement.

The Act also provides in Section 18 that where the interest of the owner is held jointly or held in common with another person who ought reasonably to have known of the improvement, that other person will have his or her interest subject to the lien unless the joint owner or owner in common disavows any responsibility for the improvement before it starts.

There is a significant exclusion to the definition of "owner" of particular importance. "Home buyers" are excluded from the definition of "owner". The reason for this is to exempt homebuyers from the risk of buying a home (defined as a one family dwelling unit) that might be subject to unregistered lien rights. It is important to note that to be a "home buyer" a deposit of not more than 30% can be provided to the builder and the home can not be conveyed until it is ready for occupancy.

Once it has been determined that the party is entitled to a lien, there are a number of other significant issues to be considered:

- (i) Premises to be Liened;
- (ii) Crown Lands;
- (iii) The Price of the Contract;
- (iv) General Liens;
- (v) Timing of When Liens Arise; and
- (vi) Limitation on Value of Liens.

(iv) *Premises to be Liened*

Once a party is entitled to a lien, the party is entitled to a lien on the owner's interest in its "premises". It is interesting to note that it does not simply grant a lien on the lands (the definition of which expressly excludes the improvement). Rather the lien is on the "premises", which is also defined.

The word "interest" in the premises includes any legal or beneficial interest in the lands such as registered owner, mortgagee, vendor, purchaser and leasehold interests.

The definition of "Premises" includes:

- The improvement,
- All materials supplied to the improvement, and
- The lands occupied by the improvement or enjoyed therewith.

It is interesting to note that lands "enjoyed therewith" are lienable, even though they may not have had the benefit of any improvement. Generally, to fall within this extension, it is important to establish that the lands "enjoyed therewith" are adjacent to the lands on which the improvement was constructed and are used for a common purpose.

(v) Crown Lands

While the Act is binding on the provincial Crown pursuant to Section 3(1), the Act provides that liens do not attach to:

- the interests of the Crown⁸ in premises,⁹ or
- premises that are a public street or highway owned by a municipality, or a railway right of way.¹⁰

In the above circumstances, the lien does not attach to the premises, but rather, constitutes a charge against the holdbacks required to be held under the Act.¹¹ This is because the interest of the Crown in the land is not capable of being sold in the event of non-payment (as it can in privately owned lands). The remaining provisions of the Act continue to apply,¹² without the requirement for registration of the lien on the premises. The manner in which liens against interests of the Crown are preserved and perfected are outlined below.

(vi) The Price of the Contract

The Act defines the contract or subcontract price to mean the price agreed on between the parties or where no specific price has been agreed, the actual value of the services or materials supplied to the improvement.

The importance of this is that it permits lien claims, where no price has been agreed to, to have a lien on the basis of quantum meruit. Many claims for extras can also be justified as lienable under the construction contract which may have a provision for extras (even though the amount payable to the contractor may have to be agreed or determined in litigation) or on the basis of quantum meruit.

It is important to note that while many construction contracts expressly provide for interest on unpaid amounts, a party is not entitled to the protection of the Act for claims of interest. However, this does not prevent the party from looking to and obtaining a personal judgment for the amount of interest it is entitled to from the party it had a direct contract with.

(vii) General Liens

The Act provides what is called a “general lien” in circumstances where an owner enters into a single contract for improvements on more than one premises (i.e., a housing subdivision). Any person supplying services or materials under that contract, or a subcontract under that contract, may choose to register the person’s lien as a general lien against each of those premises for the price of all the services and materials supplied to all premises.

If one or more of the premises subject to an unregistered general lien are sold, the purchaser takes title free of the general lien and the full lien claim continues against the premises not sold.

If the lien claimant under a registered general lien grants a release of the registered lien against one of the premises for purposes of its sale, then the full lien claim continues against the other premises.

If a general lien arose on, say, 25 lots and 24 lots were sold, the total lien would affect the owner’s interest in the last lot – a mortgagee on that lot may find that the lien for the amount of the deficiency in the holdback on all 25 lots may have priority over his/her interest in this one last mortgaged lot.

(viii) Timing of When Liens Arise

A party’s lien arises when they first supply services or materials to an improvement. This is important in that the statutory protections of the Act immediately come into play once the work is commenced. There is no need for giving of notice or registration on title. Accordingly, any party dealing with the lands where an improvement is in progress should determine whether lien rights have been created and – depending on their involvement (i.e., as construction worker, owner or lender, for example) – ensure strict compliance with the Act to make sure their rights are protected.

⁸ “Crown” includes a Crown agency to which the *Crown Agency Act* applies, *supra* note 1, s. 1(1) “crown”.

⁹ *Supra* note 1, s. 16(1)

¹⁰ *Supra* note 1, s. 16(3)

¹¹ *Supra* note 1, s. 21 and outlined in more detail below.

¹² *Supra*, note 1, s. 3(1).

(ix) Limitation of Value of Liens

The Act specifically limits the lien of a person to the amount owing to the person in relation to the improvement (which prevents lien claimants from adding other unrelated claims) but also limits the lien to “the least amount owed in relation to the improvement by a payer to the contractor or to any subcontractor” for whom the party claiming the lien dealt with. In other words, the lien claimant can claim no more than what their contractor or subcontractor is owed from up the construction pyramid. This is entirely subject to the Holdback provisions of the Act.

In determining the above amount (and again subject to the Holdback provisions of the Act), the amount may be further reduced due to claims of set off for claims, debts and damages.

This provision has the following effect. A lien claimant may find that its lien claim is limited to the amount of the holdback due to set off claims between the parties above them in the construction pyramid. The lien claimant may not have had any part in, or have any responsibilities for these set off claims, but the lien claimant’s recovery is limited.

A limitation is also placed on the value of liens against highways or roads that have been transferred to a municipality, to the value of the holdback that would have been required for the improvement.

To ensure that parties do not preserve liens or give written notice of a lien in an exaggerated amount or where no right to a lien exists, the Act provides that where the party knows or ought to know that the right to a lien didn’t exist or the amount claimed is grossly in excess of what is owed, the party is liable to anyone who suffers damages as a result.

(b) Maintaining a Claim for Lien

Once the above are considered and a party believes they are entitled to a lien, the party must carefully and strictly (subject to the curative provision) comply with the requirements of Part III of the Act to enforce their lien. Failure to do so is usually fatal to the lien claim.

There are a number of steps that parties must take to enforce their lien rights and to ensure those rights do not expire. The significant issues to be concerned about are the following:

- a) Completion of the Contract;**
- b) Preservation;**
- c) Perfection;**
- d) Expiry of Lien; and**
- e) Judicial Proceedings.**

As set out above, a lien arises once the work is commenced. However, it is not common for parties to lien the premises immediately as the lien can only be registered for the value of the work done to the date of registration. Therefore, liens are generally registered once a dispute as to payment arises. If a person entitled to a lien does not preserve (register) the lien before the end of the “45 day period” required by the Act, the party loses its lien rights. It is said to expire. As a result, the party also loses all rights to any holdback. Even if the lien expires, the party does NOT lose their rights to seek a personal judgment against the party they had a contract with.

The issue of enforcing lien rights generally only arises when the party is not paid during the course of the improvement or at the completion of a contract. If a party ceases to continue its supply of services or materials to an improvement for whatever reason, the 45 day period for preservation of the lien should be easily calculated. However construction parties need to be aware that, in some cases, the Act automatically starts this critical 45 day period regardless of whether the party is still working on site near the completion of the work on the improvement.

Therefore, in order to understand this critical 45 day period within which a lien must be preserved, it is important to understand how the Act deals with the completion of contracts.

(i) Completion of Contract

There are certain rules for completion of “contracts”, which are the contracts between owner(s) and the contractor. These rules do NOT apply to subcontracts.

A **contract** is “substantially performed”:

- a) when the improvement to be made under that contract or a substantial part thereof is ready for use or is being used for the purposes intended; and
- b) when the improvement to be made under that contract is capable of completion or, where there is a known defect, correction, at a cost of not more than:
 - i) 3% of the first \$500,000 of the contract price;
 - ii) 2% of the next \$500,000 of the contract price; and
 - iii) 1% of the balance of the contract price.

A **contract** is deemed to be completed when the price of completion or correction of a known defect is not more than the lesser of 1% of the contract price or \$1000.

A **subcontract** is completed when it is completed in accordance with the terms of the contract between the subcontractor and the contractor.

The Act provides that the payment certifier or, if there is none, the owner and the contractor jointly, shall upon application by the contractor determine and certify **substantial performance** of the **contract**. The certification of substantial performance is then published by the contractor in a construction trade newspaper (the *Daily Commercial News*) so that all the subcontractors will have sufficient notice that the 45 day lien period has commenced – the published certification of substantial performance is notice of completion of work for purposes of starting the 45 day lien period.

The contractor’s rights with regard to the remainder of the work after substantial performance is published (called finishing work) is preserved as the Act preserves the contractor’s right to lien for any unpaid finishing work.

Subcontracts and that part of the contract comprising finishing work (and giving rise to the finishing holdback) are regarded as completed by the Act if certified as completed by the payment certifier. Where there is no payment certifier, the parties may jointly make the declaration and certify completion in the prescribed form. The day of certification is deemed to be the day on which the particular subcontract is completed and the 45 day lien period then commences.

(ii) Preservation

A person’s lien rights will expire unless they are preserved by registering a claim for a lien in the proper Land Registry Office against the title to the lands before the end of the applicable 45 day lien period. A person having a general lien (referred to earlier) may preserve it by registration against each of the lands described in the contract and the amount of claim against each land may be for the price of services or materials supplied to all the lands within the time limits set out in the Act.

Having established a 45 day lien period the Act goes on to distinguish between the expiry dates of liens of contractors and others, i.e. subcontractors, workers and material men. The Act creates a complex scheme for determining when the 45 day period commences, which depends on the facts of each different situation.

(iii) Contractors

The lien period for the contractor (the party who has contracted directly with the owner) will expire 45 days after the earlier of:

- publication of the certificate of substantial performance; or
- the date the contract is completed or abandoned.¹³

¹³ *Supra* note 1, s. 34(2).

If there is no certification or declaration of substantial performance of the contract or for services or materials supplied after the date of substantial performance, the contractor's lien expires on the earlier of 45 days after the contract is completed or abandoned.

(iv) Subcontractors and Suppliers

The lien period for subcontractors and material suppliers, for services or materials supplied on or before the date of substantial performance will expire 45 days after the earlier of:

- publication of the certificate of substantial performance,
- the date when the person last supplied services or materials to the improvement,
- the date the subcontract is certified complete under section 33, where the services or materials were provided under that subcontract.¹⁴

In the same way as contractors, the subcontractor or supplier's rights for services and materials supplied after the date of substantial performance is preserved for the value of this finishing work.

These the statements are intended to illustrate the usual case and each set of circumstances must be considered individually and on its own facts. If a person entitled to a lien loses its lien rights by failure to preserve, the party still retains the usual legal remedies under his or her contract but only with the other party or parties to the contract.

(v) Contents of the Claim for Lien

A claim for lien must contain:

- the name and address for service of the person claiming the lien;
- the name and address of the owner of the premises;
- name and address of the person for whom the services or materials were supplied;
- a description of the services/materials supplied and the time within which they were supplied;
- the contract or subcontract price;
- the amount claimed for the services or materials that have been supplied; and
- a description of the premises sufficient for registration if the lien attaches to the premises, or the address or other identification of the location of the premises where the lien does not attach to the premises.¹⁵

Failure to provide the correct information in the claim may invalidate the lien. While the court has some discretion to cure minor irregularities, errors that cause prejudice (i.e. incorrectly naming the owner or the premises) can be fatal.¹⁶

The claim for lien must also be verified by an affidavit.¹⁷ The Act now provides that the claim for lien can be electronically registered. Courts have held that the electronic statement contained within the electronic form provided for in the regulations is sufficient to satisfy the affidavit requirements of the Act where the lien attaches to the premises. However, this is not the case where the lien does not so attach to Crown lands, as noted below.

(vi) Preserving When Owner is a Crown Agency

In cases involving Crown property, the lien is preserved by giving a copy of the claim for lien, along with an affidavit of verification, to the office prescribed for the particular Crown agency by regulation, or if not prescribed, to the ministry or Crown agency for whom the improvement was made.¹⁸ Failure to serve the claim for lien on the proper party is fatal, as

¹⁴ *Supra* note 1, s. 34(3).

¹⁵ *Supra* note 1, s. 34(5).

¹⁶ *Supra* note 1, s. 6.

¹⁷ *Supra* note 1, s. 34(6). See *Engineered Construction Ltd. v. Arena Entertainment Corp.*, [2006] O.J. No. 5882 (S.C.J.).

¹⁸ See Section 34. Note that section 34(1)(b) of the Act requires the lien claimant to “give” the owner a copy of the claim for lien and affidavit

is the failure to provide a duly sworn affidavit.¹⁹ As a result, electronic registration of a claim against Crown lands, on its own, will be insufficient to preserve a claim for lien, because the court has held that the electronic form does not meet the requirements of an affidavit.

To determine whether the owner is a Crown Agency, one needs to consider:

- the *Crown Agency Act*, section 1, which defines the term;
- the governing legislation of the agency, which may state the fact (i.e., universities); and
- if not outlined in above, common law principles setting out indicia of Crown agency, such as the nature and degree of control the Crown exercises over a particular body.²⁰

If there is any doubt, it is best to comply with both section 34(1) and (2) of the Act to fully preserve the lien claimant's rights.

(vii) Perfection

If a lien has been properly preserved, it becomes perfected when an action to enforce the lien has been commenced and a certificate of action is registered against title to the premises. This must be completed prior to the end of the 45 day period following the last day on which the lien could have been preserved, otherwise the lien and its underlying rights will expire. There is always some confusion with this date but simply put, perfection must take place within 90 days of the date when the first 45 day lien period for preservation started.

To illustrate the timeline, if a contract is certified to have been substantially performed (but not completed) on May 1st – publication of the certificate of substantial performance in a construction trade newspaper takes place on May 12th – the contractor's lien rights would expire 45 days after May 12th, namely, on June 26th. Assume that due to circumstances the contractor decided to register his or her claim for lien on June 1st since he or she anticipated that he or she might not get paid – the lien would expire, unless it were perfected, by August 10th which is 45 days next following the last day on which the lien could have been preserved, i.e. June 26th (90 days after May 12).

Unless a lien has been preserved within the applicable time period, it will be deemed to have expired and may not be perfected. Unless the preserved lien is perfected, the lien will have expired. Unfortunately, these time periods must be strictly met as the curative provision will not assist a party. Once a lien is expired, it cannot be revived.

(viii) Perfection by Sheltering

There is an important exception to the above requirement for perfection. It is called sheltering. A lien claimant who has properly preserved his or her lien in certain circumstances may be entitled to “shelter” under the certificate of action of another lien claimant.²¹ There are some complex rules as to when this is permitted. This avoids the necessity of the sheltered lien claimant having to perfect itself. However, care must be taken by lien claimants in relying on the sheltering principle as a sheltering lien claimant can only claim against defendants and for the relief claimed in the statement of claim under which it is sheltered.

There are two concepts regarding sheltering, vertical sheltering or horizontal sheltering. An example of vertical sheltering is where a contractor has preserved and perfected its lien for the amounts owing to it by the owner (which includes amounts the subcontractor is owed by the contractor), the subcontractor could in those circumstances safely rely on sheltering (provided it met the other rules). Vertical sheltering does not work in the reverse order (i.e. the contractor trying to shelter under the subcontractor's perfected lien) as a subcontractor's claim would only be against a contractor for amounts owing

of verification. Section 87 of the Act states that where documents are to be “given” they may be served in any manner permitted under the rules of court, or by certified or registered mail to the intended recipient's last known mailing address.

¹⁹ *John Bianchi Grading Ltd. v. Eastern Construction Company Limited* (2005), 51 C.L.R. (3d) 111 (Ont. Dist. Ct.).

²⁰ See *Westeel-Rosco Ltd. v. South Saskatchewan Hospital Centre*, [1977] 2 S.C.R. 238; *Northern Pipeline Agency v. Perehinec*, [1983] 2 S.C.R. 513.

²¹ *Supra* note 1, s. 36(4).

to the subcontractor. Since sheltering limits the sheltered lien to the claim issued, there would be no benefit or assistance to the contractor in this case.

With regards to horizontal sheltering, there is considerable controversy as to whether this is possible but there is authority, which permits it.²² In essence, the court suggested that one subcontractor (to the general contractor) was entitled to shelter under another subcontractor (to the same general contractor) even though the nature of the services or basis for the claim was entirely different.

It is safe to say that no prudent practitioner would rely on sheltering. There is no harm in a party perfecting its own lien and commencing its own action seeking relief specific to it. This would avoid the risks and problems that could be encountered if the lien document is attempting to shelter.

(ix) Trial Date

The Act attempts to ensure that construction lien claims are dealt with in a summary and expeditious manner. As a result, it imposes on the lien claimant the obligation of moving its lien claim along even after the lien is preserved and perfected.

If a trial date is not obtained or if a lien action is not set down for trial in which a lien may be enforced within two years from the date of the commencement of the action, the perfected lien expires.²³ The court has very strictly interpreted this section, and unless the party can show that the failure to comply is not the result of its own action/inaction, the failure will be fatal to the claim.²⁴ The court in such circumstances has the discretion to permit the action to continue without a lien claim, or dismiss the action altogether.²⁵ However, failure to set down a trial date within the two years exposes the claimant to significant risk that both its lien and action will be dismissed.

(c) Pre-Trial and Trial

While many, if not most, construction contracts or subcontracts contain provisions for arbitration of construction disputes, most construction disputes are dealt with by way of an action in the Superior Court of Justice of Ontario. In Toronto, Construction Lien masters not only case manage construction lien claims but also are the judicial officers who preside over the reference directed to them to decide the claims. The benefits of Construction Lien masters is that they are intimately familiar with the Act and the case law. Therefore, less time in a reference is needed to explain concepts of holdbacks, sheltering etc.

The Act provides that the Court dispose of all claims relating to the improvement, including lien claims, holdback claims, set-offs, crossclaims, counterclaims and third party claims. This allows claims such as extras, quantum meruit and the like to be heard at the same time as lien claims even though such claims do not arise under the Act.

The only prohibition – and it is an express prohibition – is that “trust claims” under the Act are not to be tried with lien claims. It was felt by the Committee that trust claims are different in nature and might result in the delay of the judicial determination of lien claims.

Section 67(1) of the Act states that the procedure in a lien action is to be as far as possible and of a summary character. This attempts to streamline the lien action and have the matter determined quickly. To do this a number of safeguards are included in the Act, including:

- No third party claims can be brought without leave of the court, and
- No interlocutory steps can be taken without leave of the court.

²² *Sesco Ltd. v. Life Centre Non-Profit Housing Corp. (Ajax)*, [1996] O.J. No. 3204 (Gen. Div.).

²³ *Supra* note 1, s. 37(1).

²⁴ See *310 Waste Ltd. v. Casboro Industries Ltd.*, 2006 CarswellOnt 5779 (Ont. C.A.), *Mohiuddin v. Ahmadiyya Movement in Islam (Ontario) Inc.*, (1995), 24 C.L.R. (2d) 127 (Ont. C.A.). But, see also *MacKenzie Group Inc. v. Hobby Jewellery Ltd.*, 2007 CarswellOnt 3489 (Ont. S.C.J.).

²⁵ *Supra*, note 1, sections 46 and 47. See also *Teepee Excavation & Grading Ltd. v. Niran Construction Ltd.*, 2000 CarswellOnt 2335 (Ont. C.A.).

However, in practice, it is clear that construction lien actions do not differ very much from a normal action. There are typically documentary production exchanged, examinations for discovery, expert reports, viva voce evidence at the hearing and so on. The intended summary nature seems to have disappeared in construction lien action.

There are numerous provisions in the Act that provide for procedures unique to Construction lien actions such as Settlement Meetings. Outlining all of these differences is beyond the scope of this chapter. Instead, the following is a list of some of the significant differences between lien actions and typical civil actions:

- (i) **Discharge or Vacating Liens**
- (ii) **Carriage of an Action**
- (iii) **Right to Information**
- (iv) **Determination of Holdback**
- (v) **Appointing a Trustee**
- (vi) **Determination of Priorities**
- (vii) **Sale of the Premises**

Once a lien has been registered under the Act, there are a variety of ways in which the claim for lien can be discharged or the registration vacated from title.

(i) Discharging or Vacating Liens

As set out above, the Act gives the party enhancing the value of the lands security (subject to the limitations in the Act) on the Premises for the payment of the services and materials supplied. However, the Committee recognized the fact that liens may arise as a result of genuine disputes and liens should not be allowed to hold up the completion of the improvement or dealing with the Premises upon completion.

Therefore, one of the unique features of the Act is to allow parties to the lien dispute to vacate the registration of the liens from title. This is done by way of a motion. This can be accomplished as of right provided that the full amount of the lien claim, together with the amount specified for costs are paid into court. If security instead of money is posted, the security needs to be in the form dictated by the Act.

The effect of vacating the registration of a lien results in, that particular lien claimant, looking to the funds in Court as security instead of an interest in the Premises. In other words, once vacated, the owner and lenders can deal with the lands as they see fit and the lien claimant no longer has a claim to the lands and, instead, must assert his or her claim against the funds in Court.

It is important to appreciate the distinction between discharging and vacating a lien. A discharged lien results in no further rights to that lien claimant under the Act. Once a lien is discharged, it is discharged forever and cannot be revived by the party who registered the lien. A vacated lien simply means that the lien claimant's rights under the Act are preserved but the security is the monies in Court rather than the lands which have had the liens vacated from title.

The particulars of how liens may be discharged or registration vacated from title are as follows:

- i) by the lien claimant executing a release of lien in the prescribed form (Form 14) and registering on title. This is in essence a discharge of lien;
- ii) a lien **will** be vacated upon payment into Court of the full amount of the claim for lien plus 25% for costs (to a maximum of \$50,000 for costs). While there is a provision, which permits the Court to require only a reasonable amount to be paid into Court, this provision is never used;
- iii) a lien **will** be vacated upon posting with the Court security in the form of a Bond or Letter of Credit for the full amount of the claim for lien plus 25% for costs (to a maximum of \$50,000 for costs); and
- iv) a lien will be discharged where a party obtains an order of a Court declaring that the lien is invalid (for example because it was registered after the 45 day lien period).

It is also open to any party to bring a motion before the Court to reduce the amount paid into Court or posted as security to vacate the lien. This can be done where the lien claimant has exaggerated the amount of his or her lien or where the amount of the Claim for Lien contains or contained amounts that are not lienable.

The discharge or vacating of the registration of a claim for lien from title does not preclude a lien claimant from asserting a trust claim against any party who may have breached the trust provisions of the Act (i.e. against a financial institution who has taken the amounts out of a contractor's account). Vacating a lien does not prevent a claim against a financial institution or other parties on the basis that they are an owner of the property (this is common) or to priority over a financial institution's security. These claims can continue in the construction lien action.

(ii) Carriage of an Action

As one would expect, it is not uncommon for there to be many liens registered relating to an improvement. In these circumstances, the Court will generally consolidate the actions so that common questions can be determined at one hearing.

In addition to consolidation, the Court has jurisdiction to award carriage of the action to any party who has a perfected lien. In essence, one party gets to control the process on behalf of all lien claimants and its counsel is usually entitled to costs from the amounts recovered at trial (called salvage costs).

As a practical matter, that doesn't mean each party need not retain counsel but the role of counsel for parties not having carriage of the action is substantially diminished and is usually reserved for particular issues relating to that party at discoveries and at trial.

(iii) Right to Information

The lack of information by a supplier of materials or services to an improvement may severely hamper the ability of a party to enforce their rights under the Act. As a result, the Act ensures that any party has the right to obtain certain information from other parties in the construction pyramid.

Section 39 of the Act gives to a variety of parties the ability to obtain information to determine the state of competing claims to an interest in the property to which the improvement has taken place. The information can be as basic as obtaining the proper legal description of the property to information such as the names of the parties who are involved in the construction process and the state of accounts between the various parties. The information request may be directed at an owner, mortgagee, contractor or subcontractor.

A request for information under Section 39 of the Act is mandatory in that the information is to be provided within 21 days of the request. The failure to do so will make the party failing to provide the information liable for damages to anyone who has suffered damages as a result of the failure to provide the information.

Accordingly, this is a useful and often used tool in determining the state of accounts, the amount of holdback, the amount outstanding on registered mortgages and whether there are trust monies.

(iv) Determination of Holdback

Holdback will be discussed in greater detail below. Since a lien is a charge on the holdbacks to an improvement, it is necessary for the Court to embark upon an enquiry as to which parties were obligated to retain the holdback, what the proper amount of the holdback is, any deficiency in the amount of holdback, and which parties are entitled to it and in what amounts.

The failure to properly holdback the statutory amount may result in either a personal judgment against the party who was supposed to withhold but failed to do so or, in the case of a lender, may result the mortgagee losing its priority over their security on the Premises. Clearly, this is an significant part of Construction Lien trials.

(v) *Appointing a Trustee*

There are certain projects, which, as a result of financial pressures or disputes between the parties to the improvement, the improvement itself is at risk to everyone's detriment. In similar situations unrelated to construction, the Court has a broad discretion for the appointment of Receivers and Managers to a corporate enterprise. A similar type of protection is made available in the Act.

Clearly, where the Owner of the Premises has significant financial resources available, it would not be in its interest to allow a Trustee to be appointed. This can easily be avoided by having the Owner vacate the lien claims by the process described above and complete the project. It is where the Owner doesn't have the financial resources to do this that this remedy is useful.

Any person, whether a lien claimant, an owner or other person having an interest in the property can apply to a Court for the appointment of a Trustee. This extraordinary remedy is considered only where there are a large number of lien claimants and it is desirable to deal with the property for the purpose of immediate completion of the project and/or sale or the competing claims of the parties will delay the disposition of the property.

The Court may appoint a trustee on any terms it considers appropriate and may also require the trustee to post security. Once this is done the trustee essentially acts in the same manner as a court appointed receiver/manager and may mortgage, sell or lease the property or complete the property all within the supervision of the Court.

The value of the Premises must be sufficient to take into account the trustee's fees, which become a first charge on the Premises. This procedure also ensures that advances to a trustee to complete project are a first charge ahead of the lien claimants.

This section is of significant importance to a financial institution because the application may be brought by a lien claimant for the appointment of the trustee. Given that the trustee may eventually be given the right to sell the lands free and clear of the liens and the mortgages, the financial institution may lose the control it enjoys as mortgagee.

On the other hand, the application to appoint a trustee is usually made by the financial institution that knows further funds are required to complete the project but the safest and most secure way to advance these funds by the financial institution is through a Construction Lien Trustee. In this way the financial institution is guaranteed that these additional funds will be the first to be repaid when the Premises are sold whether or not the lien claimants are seeking priority over the financial institution's mortgage.

The Trustee has broad ranging power to complete and sell the property. It may do so subject to the existing registered mortgages or free and clear of all mortgages and liens.

The issue of priority to the proceeds of sale held by the Trustee (except for advances to the Trustee directly) usually becomes a hotly contested issue between the lien claimants on one side and the mortgagees on the other.

(vi) *Determination of Priorities*

One of the difficult tasks of the Court in a Construction Lien Action is to determine the respective priorities between lien claimants, owners and mortgagees. While the Act grants lien claimants certain rights against the Premises as security, it is done in the context of balancing the rights of other parties (registered interests or not).

Part XI of the Act sets out the rules the Court is to apply to determine the competing interests of the parties and their respective priorities. These rules are discussed in more detail below.

(vii) *Sale of the Premises*

In addition to the Court having jurisdiction to deal with all claims relating to the improvement (including lien rights, holdbacks, personal claims and priorities), section 62 (5) gives the Court jurisdiction to order the sale of any interest in the

Premises and determine which parties are entitled to share in the proceeds of sale. Where these proceeds are insufficient to meet the obligations determined by the Court,, it may grant personal judgments against the persons found liable for the deficiency.

III. HOLDBACKS

The Act creates “holdbacks” which a payer is obligated to ensure is available for lien claimants. The Act then makes the lien a charge on holdbacks as a method for a lien claimant to have access to these holdbacks that they would not otherwise have since they have no privity of contract with the payer.

As stated above, the concept of “holdback” was established to provide some financial protection for those persons who have worked on or supplied materials to an improvement, thereby enhancing its value, but who would not otherwise be entitled to assert a direct claim against the party paying the payer, since they have no privity of contract. So long as an owner properly holds back 10% of the price of services or materials supplied, those funds will take the place of the “improvement” and the lien claimant will be unable under the Act to exercise a lien against or otherwise interfere with the owner’s interest in the premises.

The Act creates a holdback by making any person obligated to make a payment under a contract or a subcontract obliged to holdback 10% of the price of the services or materials *actually supplied* until such time as the time for preserving liens has expired, the liens are satisfied, discharged or payment is made into court. This obligation applies whether the contract or subcontract provides for partial payments as the work is done or full payment on completion.

Each party who breaches this holdback obligation is liable to the parties entitled to the holdback for the amount of any deficiency in the holdback. Conversely, if a party properly maintains the holdback and pays that amount into a lien action, generally, liability to parties with whom they have no privity is at an end. The Act specifically provides this limitation of liability to non privity parties in Section 23.

With respect to a construction pyramid for example, if an owner makes progress payments to a contractor from time to time on the basis of an architect’s certification of the value of the services or materials supplied under the contract, the owner is obliged to holdback 10% of the certified amount. Similarly, the contractor must holdback 10% of the amount owing by it to each of its subcontractors; each subcontractor must holdback 10% of the amount owing to each of its subcontractors; and so on down the construction pyramid.

The Act provides two types of holdbacks:

- i) the “basic holdback” which represents 10% of the price of services or materials supplied under a general contract or subcontract – this holdback is for the benefit of those trades who supply services or materials to the improvement before the date of certification or declaration of substantial performance;
- ii) the “holdback for finishing work” is contemplated where a contract has been certified or declared to have been substantially performed but services or materials remain to be supplied in order to complete the contract – in such circumstances a separate holdback equal to 10% of the price of the remaining services or materials must be retained until completion or abandonment of the contract.

The significance of the holdback for a mortgagee is that under certain circumstances, the mortgagee can lose priority of its mortgage to the extent that the owner fails to maintain the holdback fund required by the Act.

Simply put, in most cases, all a party to an improvement (from the mortgagee and the owner right down to the suppliers of materials) needs to worry about is its own contract(s) and the holdback requirements. Comply with these and the Act will not be a problem with regards to holdbacks.

Each time a payment is to be made on a construction project, whether it be a progress payment or a completion payment, the requirement for a holdback needs to be considered.

Where the concept of holdbacks becomes more complex is the mechanics of entitlement taking into account the various payment streams in a project are considered. A payment stream is the following. The owner generally only has one payee. The general contractor may have a few subcontractors, each of which is a payment stream of the contractor. The subcontractors may each have a number of sub sub contractors, each of which is a payment stream of the subcontractors. This payment stream follows the construction pyramid talked about above.

Each lien claimant is only permitted to look to his payment stream and what should have been held back for that stream. This allows payers to comply with their obligations in a payment stream which have no lien issues, but preserves entitlement to an appropriate portion of the holdback for payment streams where lien issues have arisen.

(i) *No right of Set Off against the Holdback*

It would defeat the purpose of the Act if a payer could invoke the right of set off against the payee to reduce the holdback obligation. The payee's subcontractors or suppliers may have performed their work entirely properly and should be and are entitled to the benefits of the holdback under the Act.

As a result, the Act expressly prohibits any party from setting off against their holdback obligations unless the liens that can be claimed against that holdback have expired, been satisfied, discharged or vacated. When there is no longer a holdback entitlement, set off can be once again raised by a payer against its payee.

For example, if a contractor abandons his or her work or otherwise fails to complete the project, his or her subcontractors are nevertheless entitled to enforce their lien rights. The owner might be inclined to resist such claims on the basis that he or she would incur increased costs of completion of the contract and such costs should form a set-off against the defaulting contractor. However, according to the Act no such right exists with regard to the holdback.

(ii) *Progress Payments*

As long as a person (owners, general contractors, and others as the case may be) has received no written notice of a lien, he or she may make payment of up to 90% of the contract or subcontract price without exposing himself or herself to liability under the Act.

If, however, the person receives notice of a lien, he or she is obliged to holdback an amount sufficient to satisfy the lien *in addition* to the 10% holdback amount but may pay out additional monies owing. Only written notice of the lien will restrict the payment by the payer of the amount in excess of the holdback; registration of the Claim for Lien on title is insufficient.

However, on major projects, the lender and owner will likely conduct a title search to determine whether any Claims for Liens have been registered even if they haven't received written notice, to continue to maintain the correct amount of the holdback and enough to cover the registered liens.

(iii) *Payment on Completion of Particular Subcontracts Prior to Substantial Performance of the Contract*

When a particular subcontract has been certified completed by the payment certifier or, if there is none, by the owner and the contractor, the amount of holdback retained with respect to that subcontract may be released and paid out provided that all liens relating to the completed subcontract have expired, been satisfied or discharged.

(iv) *Payment Out of Basic Holdback*

The basic holdback may be paid out 45 days after:

- a) the date of publication of a copy of the certificate or declaration of substantial performance of the contract; or
- b) the date the contract is completed; or
- c) the date the contract is abandoned, whichever occurs first.

The purpose of Section 26 of the Act is to permit payment out of the holdback (in a manner that mirrors the provision which specifies how long the holdback retention obligation exists) but adds to that the ability of the payer to make the payment to discharge the claims against that holdback.

The practice is that before payment of the basic holdback is for the owner to search title to ensure that there are no registered liens. If it has, the owner will request a discharge before payment of the holdback to the contractor.

(v) *Payment Out of Holdback for Finishing Work*

The holdback for finishing work may be paid out 45 days after the date the contract is completed or abandoned, whichever occurs first, provided that no liens are preserved in the interim. Again a search is required to ensure that no liens have been preserved in the interim.

(vi) *Direct Payment to a Person Having a Lien*

An owner, contractor or subcontractor may make a direct payment to a person having a lien with whom he or she does not have privity of contract and that payment is deemed to be a payment by the person who was contractually obliged to make payment to the payee. There is an obligation to provide notice to the proper payer of the proposed payment.

This payment, if paid, is deemed NOT to reduce the amount of the holdback the party making the payment is obliged to maintain or the amount to be retained in response to a written notice of lien.

This section is rarely used as the risk is that the proper payer may take the position the payee's work was inadequate or defective and the direct payment would prevent that person from effectively asserting a set-off claim to force the payee to complete or rectify deficiencies in the work. Unless the proper payer expressly directs or authorizes such payment, a party would be best advised not to make a payment to a subcontractor.

IV. PRIORITIES

(a) *Mortgage priorities*

The Act starts with the basic proposition that liens arising from an improvement have priority over all mortgages, conveyances and other agreements affecting the owner's interest in premises. The only exceptions to the basic rule are those found in s.78 of the Act. There is a heavy onus that shifts to lenders to establish priority over lien claimants.

The reason for creating these priorities is because the value of the security (the Premises) is contributed to jointly through advances by a lender and by the work of the unpaid lien claimants. Therefore, where an owner becomes insolvent or cannot pay the holdback or its obligations to the general contractor, the Act attempts to strike a balance of the competing interests to the security in the Premises.

There are comprehensive rules governing the priorities between mortgagees and lien claimants. These rules establish three categories of mortgages and the priority issue is dependent upon which category of mortgage is established:

- i) building mortgage;
- ii) prior non-building mortgage; and
- iii) subsequent non-building mortgage.

It is important for a mortgagee to determine which type of mortgage described in the Act they have. The rights of lien claimants differ depending on which category the particular mortgage is found to be by the Court in the lien action. As this depends on whether the improvement has already been started, it is important for the lender to make the appropriate enquiries to ascertain whether the liens have arisen and, if so, value of the lands before the improvement.

(i) Building Mortgage

A building mortgage is defined as a mortgage taken by a mortgagee “with the *intention* to secure financing of an improvement”. Liens arising from the improvement have priority over a building mortgage to the extent of any deficiencies in the holdbacks required to be retained by the owner under Part IV of the Act. This exposure to a lender can be onerous.

The apparent misconception on the part of some lenders is that the risk is 10% of monies advanced by a lender. This is clearly not the case. The holdback and, therefore, the deficiency in the holdback has no relation to the amount of money advanced. A lender must view the project in all its components to properly assess the lending risk, as liens will relate to all improvements to the project from beginning to end.

The priority of liens is not affected by the registration date of the building mortgage or the date of any advances. This extends not only to mortgages taken to secure advances to finance improvements, but also to mortgages taken out to repay a building mortgage.

There are a number of ways for a “building mortgage” lender to protect itself:

- a) ensure proper margins are maintained;
- b) obtain personal guarantees/collateral security from the owner;
- c) Implement a Financial Guarantee Bond or Lien Holdback Deficiency Bond;
- d) have a project monitor to ensure compliance with the Act, but a lender must be careful that it does not become “owner” under the Act;
- e) policing holdback by advancing only 90% of the funds or by advancing 100% of the funds and requiring borrower to deposit 10% of each advance with lender to be held as security to fund holdback obligations. Since the funds must be advanced, it is not sufficient for a lender to maintain a “notional holdback” where advances are reduced by 10% in each instance unless the lender understands that these unadvanced 10% funds may have to be paid to lien claimants to satisfy the holdback obligations of the owner; or
- f) for “take out financing”, the lender must insure that the certification provisions of the Act have been complied with (s. 32(l)) in regard to substantial performance and that the lien has expired in regard to finishing work (that it may wish to secure by way of cash collateral account).

The lender must realize that the owner’s obligation for the holdback is ongoing, thus the holdback deficiency can be an issue up until the project is completed and all lien rights have expired.

(ii) Prior Non-Building Mortgages

A prior non-building mortgage is defined as a mortgage registered on title prior to the “time when the first lien arose in respect of this improvement”. This is a mortgage other than to finance improvements (i.e., not a building mortgage). A lien arises and takes effect when services or materials are first supplied to an improvement.²⁶

It is important to note that the definition of “when materials are supplied” can include where materials are supplied to land in vicinity of lands to be improved and that the supply of services definition also covers supply of design, plans, drawings or specifications that enhance the value of the owner’s interest in land. Therefore, it can be difficult to determine in some instances if and when a lien claim has arisen which potentially may have priority over the mortgage until all the facts come out in the action.

Once the mortgage is established as a “prior mortgage”, the Act distinguishes, and treats differently, advances made prior to first lien and advances subsequent thereto.

Prior advances (i.e., before the first lien arises) have priority, but only to the extent of the lesser of:

- a) the value of the premises at the time the first lien arose; and

²⁶ *Supra* note 1, s. 15.

b) the total amount of the advances.

Subsequent advances (i.e., subsequent to first lien arises) retain priority unless a claim for lien is registered on title or the mortgagee has received a written notice of lien. Once a lien has been registered or written notice has been given, then all liens will have priority over advances made thereafter, whether registered or not at the time of the advances.

A mortgagee can use a postponement provision to avoid lien priority where a lien claimant with a preserved or perfected lien postpones to an advance, as long as no written notice of a further lien is received by the mortgagee or registered. Obviously, a lien claimant would only allow this to occur when it believes that the infusion of the mortgagee's funds will assist to maintain the project (and hence the lien claimant's security).

(iii) Subsequent Non-Building Mortgages

A subsequent non-building mortgage is defined as a mortgage registered after the time the first lien arises. Liens arising from the improvement have priority over subsequent mortgages to the extent of any deficiency in holdbacks. Otherwise the subsequent mortgage has priority over liens to the extent of any advance made by the mortgagee unless and until a claim for lien has been registered on title or the mortgagee has received written notice of the lien prior to making the advance. Once again, all liens will have priority over advances where one lien is registered and the lender chooses to make further advances in the face of the lien.

(iv) Mortgagee as Owner under the Act

Given the broad definition of "owner" in the Act, if a mortgagee is found to be an "owner", it can assume liability to the lien claimants under the Act for holdback obligations. The degree of control and the direction of mortgagee, direct dealings with the contractor and/or subcontractors are elements that will be considered by the court, although this is generally very difficult to establish.

A mortgagee to preserve its lender status, should not become involved in the day-to-day decision making in regard to the project being financed. "Participation" mortgages increase the likelihood of a lender being found to be an owner.

(v) Home Buyers Mortgage

The Act excludes the application of the priority rules as it relates to a mortgage given or assumed by a home buyer.

(b) Priority Issues on Realization

(i) Power of Sale

Where there is a claim for lien made against the property, the mortgagee cannot sell the property free and clear of liens unless the liens are vacated prior to the sale. The only way to ensure that no liens have been claimed or will be claimed is to wait at least 45 days after the mortgagee takes possession before commencing sale proceedings.

(ii) Holdback

Lien claimants have priority for the amount of any deficiency in the holdback, which claim follows the property to a new owner unless a bond, letter of credit or guarantee is posted as security. Therefore, a seller must satisfy the purchaser that there are no liens (or possible liens which would encumber clear title to the property) or post the necessary security.

(iii) Receiver

A privately appointed receiver is in no better position to sell property than the owner or mortgagee who appointed him or her. A court appointed receiver, to be free to deal with the property, and should be specifically appointed as a Construction Lien Trustee. The advances made to a Construction Lien Trustee have statutory protection to a priority over every lien. The Act does not grant priority of the advances over registered mortgages. The Court will determine the priorities of all parties

(the registered mortgagees, the Trustee and the lien claimants) in the subsequent action.

(iv) Construction Lien Trustee

A trustee can sell property free and clear of liens. If the lien claimants have claimed priority over the mortgagee, then the Trustee usually gets Court authorization to sell property free and clear of all claims (including mortgages) and pays money into court.

(v) Priorities amongst Lien Claimants

As a general rule, all lien claimants who supply services or materials to the same payer form a class and all amounts available to each class is distributed ratably among the members of the each class. Further, the lien of every member of a lien class has priority over the lien of the payer of that class. In effect, this creates a bottoms up payment structure with all lien claimants within each level being treated ratably.

Any attempt by a payer to give a lien claimant a conveyance or a mortgage for the lien claim is void. This preserves the “all members of each class are equal” concept of the Act.

The one exception to this equality concept is that the Act gives workers a special priority to the extent of 40 regular working days over non workers in the same class. Similarly, funds owed to a trust for workers (i.e., vacation pay) are preserved and may be claimed by the trustee of the fund.

Lastly, where there is a general lien, it is treated ratably over the various premises and is postponed in favor of those lien claimants who supplied services or materials to a single premises. The Act provides a mechanism for calculating the amount of the postponement.

IV. THE CONSTRUCTION LIEN TRUST

The Act creates a statutory trust scheme with very significant rights of recovery to the parties supplying services or materials to an improvement. Because it is a statutory trust, the terms are found solely in the Act and are strictly construed for both the trustee and the beneficiaries of this trust. The purpose is to try and keep the funds within the construction pyramid and make any person who diverts funds personally liable. Further, it protects the funds from claims when an insolvency or bankruptcy arises of one of the parties who worked on the project.

The Act creates two trusts concepts, one for owners and one for contractors or subcontractors.

(i) Owner’s Trust

There are four owner’s trusts created:

(i) Monies received by an Owner

All monies received by an owner for financing the project (including funds for the purchase of the land and to discharge prior encumbrances) are trust funds for the benefit of the contractor.

(ii) Certified As Payable

Where there is a payment certifier, once amounts are certified as owing, the amount in the owner’s hands or received by owner, constitute trust funds for the benefit of the contractor.

(iii) Where Substantial Performance Certified

Where the substantial performance has been certified or so found by a court, the unpaid price in the owner’s hands or received by the owner, constitute trust funds for the benefit of the contractor.

What is significant in the last two scenarios is that the trust is created for both monies which may be received by the owner, and for monies already in the owner's hands. In other words, even if the owner is not borrowing funds for the project but instead using its own funds, the funds in the owner's hands become trust funds.

iv) Sale of Premises by Owner

Where the Owner sells its interest in the Premises, the proceeds of sale (less expenses and discharge of mortgage amounts) are trust funds for the benefit of the contractor

Until the contractor is paid all amounts owed to him or her, the owner cannot appropriate the funds or use them for some other purpose.²⁷

(ii) Contractor's Trust

All amounts:

- Owing to a contractor or subcontractor (whether due or payable); and
- Received by a contractor or subcontractor

on account of the improvement are deemed to be trust funds for the benefit of those owed money by the contractor or subcontractor.²⁸

The provision here was intended to catch all monies which would be coming to or have been received by the contractor or subcontractor for the benefit of other suppliers below. Given the broad definition of subcontractor, this in essence, continues this trust provision right down to the bottom of the construction pyramid.

Again, the contractor or subcontractor cannot use or appropriate the funds until all his subcontractors/suppliers have been paid.

There are many issues which arise in the context of the Construction Lien Trust but the following are but a few significant ones:

- Onus

Once the beneficiary establishes the trust, the onus shifts to the payer to show that there has been no breach of trust.

- Segregation of Trust Funds

While in a perfect world trust funds should be separately maintained, this is rarely the case. Where the funds are not segregated, the Courts will more readily find a breach of trust.

- Third Parties

Courts are prepared to assist a beneficiary seeking a remedy against a third party (such as a bank) who knowingly breaches a trust (and therefore benefits from the breach). However, such assistance is the exception to the general rule that only the beneficiary to the trust has the right to maintain an action for breach of trust. In other words, the law appears to be that a subcontractor cannot bring a breach of trust claim against an owner. This is one of the serious shortcomings of the trust provisions of the Act.

(iii) Reduction of Trust Obligation

Every payment (except holdback monies) made by someone holding trust monies to a person he or she is obliged to pay, reduces his or her trust obligation by the amount so paid. This allows, for example, the owner to pay the contractor to reduce the owner's trust obligation. However, this immediately creates a trust obligation on the contractor to the subcontractor.

²⁷ *Ibid.* s. 7(4).

²⁸ *Ibid.* s. 8(1).

Completely opposite to the manner in which holdback monies are treated, the Act expressly allows a person who has trust monies to set off against a party he or she is liable to pay, the amount of such set off. The set off may relate to the improvement (i.e., defective work) or to any other obligation between the parties. The only stipulation is that a party can only set off against a person to whom he or she had a direct obligation to pay.

Another permitted application of trust money, which doesn't constitute a breach of trust, is the repayment of a loan relating to the project.

(iv) Personal Liability for Breach of Trust

In addition to the payer being in breach of trust if the Act is not complied with, every

- director,
- officer, or
- any other person having control of the corporation

who participated, assented to or acquiesced in the breach of trust, will also be in breach of trust.²⁹ The two elements a claimant will have to prove are:

- the person is a director, officer or had effective control of the corporation and its relevant activities; and
- the person engaged in, assented to or acquiesced in conduct he/she ought to have known amounts to a breach.

To determine if someone had effective control over the corporation, the court will consider the person's:

- role in the financial affairs of the corporation
- handling/control over trust funds
- authority to sign cheques or decide which parties would be paid
- authority to sign statutory declarations.³⁰

Once effective control is established, the court will assess whether a reasonable person in the same position knew or ought to have known that his or her conduct amounted to a breach of trust. Actual knowledge or intent need not be proven.³¹

More than one participant can be liable for breach of trust, and in such cases, they will be deemed to be jointly and severally liable.

V. CONCLUSION

For a statute that has only 88 sections, the complexity of its application is extensive. There are many construction projects in this province with unique and novel construction delivery vehicles, unique financing, varying types of construction contracts and so on. The application of the Act requires an excellent understanding not just of the sections but also of the rationale behind the Act and a complete overview of the case law.

The fact that the rights and obligations in the Act are entirely statutory and, generally, require strict compliance, make it a minefield for members of the construction industry who fail to comply.

²⁹ *Ibid.* s. 13(1).

³⁰ *Malcolm Group Contracting Inc. v. 84289 Ontario Inc.*, [2003] O.J. No. 4 (S.C.J.), *Sunview Doors Ltd. v. Academy Doors and Windows Ltd.*, [2007] O.J. No. 1916.

³¹ *Tam-Kal v. Stock Mechanical Inc.* (1998), 43 C.L.R. (2d) 94 (Ont. Gen. Div.) aff'd [1999] O.J. No. 4371 (Ont. C.A.).