

**TAB 4**

**The Construction Lien Trustee**

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**Practice Gems – Construction Lien Essentials**



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## The Construction Lien Trustee

Duncan W. Glaholt

### 1. Introduction

It was recognized early on in Ontario that troubled projects deteriorate rapidly. They pose safety concerns. They depreciate in value. All of this is to the prejudice of lien claimants. The task of provincial legislators during the last depression was to devise a constitutionally acceptable way of completing troubled projects without entrenching on federal insolvency powers. Simple receivership was not an answer because it did not allow completion of the improvement in the face of liens. What was needed was a remedy competent to a provincial legislature that focused on the “improvement” itself and not necessarily on insolvency of the owner or contractor.

Accordingly, in 1932, s. 8 of *An Act to Amend the Mechanics' Lien Act*<sup>1</sup> allowed persons having an interest in the subject premises to apply to appoint a receiver or trustee to collect rents or profits and manage, sell or lease the premises. The following subsections were added to s. 32 of the Act:

- (3) At any time after the delivery of the statement of claim, as provided by this Act, the judge or other officer having jurisdiction to try the action may, on the application of any lien

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<sup>1</sup> S.O. 1932, c. 19.

claimant, mortgagee or other party interested, appoint a receiver of the rents and profits of the property against which the claim of lien is registered, upon such terms and upon the giving of such security or without security as to the said judge or other officer may seem just.

- (4) At any time after the delivery of a statement of claim as provided by this Act, any lien claimant, mortgagee or other party interested, may make an application by way of originating notice to a judge of the Supreme court in chambers who shall have power to appoint, upon such terms and upon the giving of such security or without security as the judge deems best, a trustee with power to manage and sell the property upon which the lien is filed, such management and sale to be under the supervision and direction of the court, and shall be approved by the court.
- (5) The judge in chambers may in his discretion, refer the application so made to the judge or officer having jurisdiction to try the action, who may hear *viva voce* of affidavit evidence upon the application, and who shall have the same powers as are conferred upon the judge under subsection 4.
- (6) Any property directed to be sold under the provisions of this section, may be offered for sale subject to any mortgage or other charge or encumbrance if the judge or other officer having jurisdiction so directs, but only in cases where there is no dispute whatever as to the priority of any such mortgage.
- (7) The proceeds of any sale made by a trustee under the provisions of subsection 4 or 5, shall be paid into court and be subject to the claims of all lienholders, mortgagees or other parties interested in the lands so sold as their respective rights may be determined and in so far as applicable the provisions of section 36 shall apply.
- (8) The judge of the Supreme Court or the judge or officer having jurisdiction as aforesaid as the case may be, shall make all necessary orders for the completion of the sale for the vesting of the property in the purchaser.

- (9) Any such vesting order so made of property so sold by a trustee appointed as aforesaid shall vest the title of the property free from all lienholders' claims, encumbrances and interests of any kind including dower, except in cases where sale is made subject to any mortgage, charge, encumbrance or interest as hereinbefore provided, but nothing in this section or in this Act shall be deemed to extinguish the right to dower, if any, of any married woman or the right to have the value of the same ascertained and deducted from the proceeds of the same so paid into court.

The provision remained substantially unchanged until the introduction of the *Construction Lien Act* in 1983. The Attorney General's Committee on the Draft *Construction Lien Act* commented as follows:

Basically, the proposed provision permits the appointment of a trustee to manage, sell, mortgage or lease the premises and to complete, or partially complete, the improvement. The Committee is of the opinion that the registration of a lien should not be the condition precedent of an application for the appointment of a trustee. Rather, any person having a lien, or who has an interest in the property, should be able to apply under s. 70 [now s. 68]. The proposed subsection has been amended to reflect this opinion. Subsection 2 sets out the powers of the trustee. All powers were to be exercised under supervision of the court. The power to sell or lease the premises may only be exercised with the approval of the court. Such a disposition will also be subject to the terms of the *Planning Act*. As indicated in the notes under Section 71 [now s. 69], the powers of a trustee have been expanded to allow for the receipt of rents and profits. The Committee also decided that liens on the property being administered should be a charge on rents and profits realized. The charge should only extend, however, to the net proceeds remaining after the normal expenses of managing the property had been paid. These net proceeds should

be paid into court and dealt with in the same manner as proceeds of sale under section 68  
[now s. 66] of the proposed Act.<sup>2</sup> (emphasis added)

Thus, section 68 of the *Construction Lien Act* now provides as follows:

*Application for appointment of trustee*

(1) Any person having a lien, or any other person having an interest in the premises, may apply to the court for the appointment of a trustee and the court may appoint a trustee upon such terms as to the giving of security or otherwise as the court considers appropriate.

*Powers of trustee*

(2) Subject to the supervision and direction of the court, a trustee appointed under subsection (1) may,

- a) act as a receiver and manager and, subject to the Planning Act and the approval of the court, mortgage, sell or lease the premises or any part thereof;
- b) complete or partially complete the improvement;
- c) take appropriate steps for the preservation of the premises; and
- d) subject to the approval of the court, take such other steps as are appropriate in the circumstances.

*Liens a charge on amounts recovered*

(3) Subject to subsection 78 (7), all liens shall be a charge upon any amount recovered by the trustee after payment of the reasonable business expenses and management costs incurred by the trustee in the exercise of any power under subsection (2).

*Sale subject to encumbrances*

(4) Any interest in the premises that is to be sold may be offered for sale subject to any mortgage, charge, interest or other encumbrance that the court directs.

*Orders for completion of sale, etc.*

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<sup>2</sup> Report of the Attorney General's Advisory Committee on the Draft *Construction Lien Act*, reprinted in Glaholt & Keeshan, *2009 Annotated Ontario Construction Lien Act* (Toronto: Carswell, 2008) 513 at p. 636-637.

(5) The court may make all orders necessary for the completion of any mortgage, lease or sale by a trustee under this section.

Section 68 is available to any person having a lien. As liens arise by the mere supply of work, services or materials to an “owner” of premises and thereafter are said to subsist,<sup>3</sup> s. 68 is available to those having subsisting unpreserved liens.<sup>4</sup> Section 68 is available to any other person having an interest in the premises. “Interest in the premises” is defined in s. 1 of the Act as “an estate or interest of any nature, and includes a statutory right given or reserved to the Crown to enter any lands or premises belonging to any person or public authority for the purpose of doing any work, construction, repair or maintenance in, upon, through, over or under any lands or premises”. Thus, a local utility with an easement would apply to complete a subdivision, for example. The broad wording of s. 68 indicates that the focus of the legislation is on the preservation of the premises and not on the interest of any particular creditor or group of creditors. It is contemplated that entitled persons “may apply to the court”. The remedy is usually (but not always) sought by an originating application under Rule 14, not by motion in an existing proceeding. This is consistent with its availability to subsisting lien claimants before perfection of a preserved lien. Courts have concluded that this is a powerful and intrusive remedy to be used with caution.

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<sup>3</sup> *Construction Lien Act*, R.S.O. 1990, c. C.30, s. 15. See generally Bristow, Glaholt, Reynolds & Wise, *Construction, Builders and Mechanics’ Liens in Canada* (Toronto: Carswell, 2005) at 1-15.

<sup>4</sup> *Royledge Industries Inc. v. Perma-Roof Ont. Ltd.* (1991), 2 O.R. (2d) 488 (Gen. Div.).

Once appointed by court order, the *Construction Lien Act* trustee may act as receiver and manager, subject to the supervision and direction of the court.<sup>5</sup> Section 68(3) of the Act makes the lien a charge upon any amounts recovered by the trustee. In order to permit a trustee to finance completion of a project, s. 78(7) provides as follows:

Despite anything in this Act, where an amount is advanced to a trustee appointed under Part IX as a result of the exercise of any powers conferred upon the trustee under that Part,

- (a) the interest in the premises acquired by the person making the advance takes priority, to the extent of the advance, over every lien existing at the date of the trustee's appointment; and
- (b) the amount received is not subject to any lien existing at the date of the trustee's appointment.

This priority is analogous to the priority routinely granted by order in the debtor-in-possession financing of CCAA proceedings.

## **2. General Duties of Trustee**

A trustee under s. 68(1) is an officer of the court. The trustee acts for the benefit of all persons having an interest in the premises and has all the duties, powers and obligations of a trustee at common law and under the *Trustee Act*.<sup>6</sup>

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<sup>5</sup> *Construction Lien Act*, s. 68(2).

<sup>6</sup> *700 King Street (1997) Ltd. (Receiver of) v. Acro Capital Inc.* (2004), 35 C.L.R. (3d) 47 (Ont. S.C.J.).

A *Construction Lien Act* trustee is held to the standard of care that a person of ordinary prudence would use in managing his or her own affairs. This is an objective standard, so that lack of experience, training, or knowledge on the part of any particular trustee is no excuse for poor performance.<sup>7</sup>

The trustee must secure the trust assets and safeguard, preserve, and enhance their value, and distribute the trust assets to the beneficiaries.<sup>8</sup> At common law and under the *Trustee Act*,<sup>9</sup> a trustee has a fiduciary duty and the title to property usually vests in the trustee.<sup>10</sup>

### 3. Who should be trustee?

There are no statutory guidelines and little, if any, assistance in the case law. The trustee is an officer of the court with all of the duties entailed in that process, plus significant financial management responsibility. For this reason, it is customary to turn to the accounting profession and nominate a professional receiver manager from that discipline. Depending on the stage and special requirements of a particular project, trustees have been engineers, lawyers and other professionals. The court may impose terms as to bonding or other performance security, and is likely to do so if the trustee is not from one of the self-governing professions.

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<sup>7</sup> Gillese and Milczynski, *The Law of Trusts*, 2<sup>nd</sup> ed. (Toronto: Irwin Law, 2005).

<sup>8</sup> Ibid.

<sup>9</sup> R.S.O. 1990, c. T.23.

<sup>10</sup> *700 King Street (1997) Ltd. (Receiver of) v. Acro Capital Inc.* (2004), 35 C.L.R. (3d) 47 (Ont. S.C.J.).

#### 4. When should a trustee be appointed?

Early authority under the former *Mechanics' Liens Act* suggested that a trustee may be appointed in two circumstances: mismanagement or abandonment of a project.<sup>11</sup> In *Durcard Mechanical Contractors Ltd. v. I.C.R. Development Corp.*,<sup>12</sup> Justice Grange held as follows:

The remedies provided under s. 34 of the *Mechanics' Liens Act* are intended to be resorted to only when the present management is clearly unable to carry on with the business, either by reason of incompetence or dishonesty or neglect of the undertaking.

[...]

I do not feel however, that the court should appoint a receiver or a trustee upon the application of one unsatisfied lien claimant where there is no evidence of abandonment of the premises or mismanagement of the project. . .

There are now three generally accepted circumstances when it may be appropriate to appoint a trustee:

1. Where the premises has income earning capacity and the lien claims could be satisfied out of that income; or
2. Where the problem is financing and the court is satisfied that the project would be viable if it was refinanced and carried to completion; or,

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<sup>11</sup> *Mechanics' Liens Act*, R.S.O. 1970, c. 267, s. 34.

<sup>12</sup> [1975] O.J. No. 438 (H.C.).

3. Where a trustee is needed to manage the premises in order to prevent their deterioration.<sup>13</sup>

These are not fixed rules, however, and the statutory grant of jurisdiction is sufficient to allow the remedy to be adapted to the circumstances of a particular case. In *Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd.*,<sup>14</sup> for example, although the case is not reported on this point, a section 68 trustee was appointed after substantial completion of a condominium high-rise *after* an occupancy permit had been issued, solely to address technical audit issues and supervise and manage all sales of a condominium for the benefit of a group of lien claimants and other creditors.

#### **4. When will an application under s. 68 be refused?**

Courts have consistently refused the appointment of a trustee where the appointment was sought for some collateral purpose.

In *Ru-Ko Inc. v. Croatia (Republic)*,<sup>15</sup> for example, the owner, the state of Croatia, had taken the position that it was entitled to diplomatic immunity from the claim of the contractor. The contractor lien claimant in that case had both preserved and perfected a

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<sup>13</sup> *Royledge Industries Inc. v. Perma-Roof Ont. Ltd.* (1991), 2 O.R. (2d) 488 (Gen. Div.).

<sup>14</sup> (1999), 42 O.R. (3d) 749 (C.A.).

<sup>15</sup> *Ru-Ko Inc. v. Croatia (Republic)* (1998), 38 C.L.R. (2d) 269 (Ont. Master).

claim for lien. In a separate proceeding, the owner had sought and lost a determination on the availability of the defence of diplomatic immunity. The owner then decided to sell the property and sought the consent of the contractor to an order to vacate the contractor's lien upon posting security into court. The contractor would not consent without an agreement from the owner that it submitted to the jurisdiction of the Ontario courts and would not claim diplomatic immunity. The owner refused to enter into such an agreement and proceeded to post security and vacate the registration of the contractor's lien without notice by paying into court the full value of the lien plus the appropriate amount for costs. The lien claimant then applied to appoint a trustee under s. 68 to receive and hold the proceeds of sale to the extent of the value of the lien.

The court refused the application, in part because as the lien had been vacated and attached to the money in court rather than the land. This analysis is correct, of course, as once security is posted the lien ceases to attach to the premises and instead becomes a charge upon security posted.<sup>16</sup> The claimant is no longer a person having a lien against the premises, but rather a lien claimant with a "charge" upon the security posted to vacate that lien.

The contractor argued that Croatia's claims of diplomatic immunity would be diminished if the sale proceeds did not pass into Croatia's hands but rather into the hands of a court

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<sup>16</sup> *Construction Lien Act*, s. 44(6). See *Akimov v. K-W Housing Co-Operative Inc.* (1984), 47 O.R. (2d) 794 (H.C.); *Benny Haulage Ltd. v. Hamilton-Wentworth Roman Catholic Separate School Board* (1996), 33 C.L.R. (2d) 44 (Ont. Master).

appointed trustee. The Master observed that the contractor's lien was not at risk as the full amount of the lien claim plus an amount for security for costs was paid into court. The Master refused to appoint the trustee and concluded that the facts of the case did not reflect the situations contemplated by s. 68 nor did they warrant the application of this extraordinary remedy. The question of whether the Master even had jurisdiction to hear an application under s. 68 will be discussed below. It was not addressed in this case.

A more common misuse of s. 68 is as to gain bargaining advantage in a genuine two sided dispute. In *Royledge Industries Inc. v. Perma-Roof Ont. Ltd.*,<sup>17</sup> the developer, Royledge, had sold its lands to Perma-Roof, a builder, on terms that required Royledge to install and pay for all of the servicing and all local and regional levies, park dedications and roadways for a subdivision of 137 lots. Perma-Roof had the right to review and approve of the subdivision agreement. Royledge, however, negotiated the subdivision agreement with the Town, without consulting Perma-Roof, who refused to execute the agreement on the grounds that it was not in accordance with the contractual obligations of Royledge. Perma-Roof changed the agreement to delete any reference to it as developer and to make it clear that all liability for the servicing, levies and dedications was the responsibility of Royledge and submitted this redraft to Royledge. Royledge refused these changes and the subdivision agreement remained unsigned. The Town would not issue building permits until the subdivision agreement was signed. This produced a classic stalemate.

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<sup>17</sup> (1991), 2 O.R. (2d) 488 (Gen. Div.).

Royledge engaged a contractor to install the services. The contractor did the work and was owed \$800,000. There was no serious dispute as to the quality or value of the work. Royledge refused to pay the contractor without the subdivision agreement being signed. The contractor liened, which, conveniently, was a way of forcing a resolution of the subdivision agreement stalemate.

Justice Lane noted that the real dispute had nothing to do with the contractor's lien and everything to do with the contractual relations between Royledge and Perma-Roof. In refusing to appoint the trustee, Justice Lane held that:

There is no vacuum in the management of these premises; the owner has not abandoned them, is not insolvent and is not acting in an irresponsible way. There is no income flow to be taken in hand for the benefit of lien claimants to avoid a sale of the premises. There is no danger of deterioration of the services that have been installed. The security of the lien claimants has not been shown to be at risk. The problem underlying this litigation is a dispute between Perma-Roof and Royledge as to the meaning of the arrangements between them and as to whether the draft contract settled by Royledge with the Town is in harmony with those contractual arrangements.

As noted, a trustee may be appointed even after the completion of the project. In *Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd.*,<sup>18</sup> for example, the trustee was appointed for the sole purpose of managing the sale of the units after a condominium project was virtually completed.

## 5. How do you go about appointing a trustee?

The relief is generally sought by originating application to a judge, however it has yet to be conclusively determined whether a party seeking the appointment of a trustee can proceed by way of motion instead of application, or by motion to a master to whom the entire proceeding has been referred by a judge. Some authorities suggest that the application / motion distinction is a mere technicality which cannot be used to defeat substantive rights.<sup>19</sup>

The judge / master aspect of this issue came before Master Sandler in *Celebrity Flooring Systems Ltd. v. One Shaftesbury Community Assn.*<sup>20</sup> The issue was whether a construction lien master had jurisdiction to hear a motion to appoint a trustee where the lien action had been referred to the master under a judgment of reference. Master Sandler's comments are *obiter*, as he referred the matter to the Divisional Court as a

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<sup>18</sup> (1999), 42 O.R. (3d) 749 (C.A.).

<sup>19</sup> *Atlas-Guest Inc. v. Brownstones Building Corp.* (1992) 2 C.L.R. (2d) 275 (Ont. Gen. Div.); *G.C. McDonald Supply v. Preston Heights* (1991) 45 C.L.R. 293 (Ont. Gen. Div.)

<sup>20</sup> *Celebrity Flooring Systems Ltd. v. One Shaftesbury Community Assn.*, [2003] O.J. No. 304 (Master).

stated case. Although the matter was never heard by the Divisional Court, Master Sandler's comments are instructive: The proper procedure suggested by Master Sandler to appoint a trustee can be summarized as follows:

No.	Circumstance	Proceeding
1.	Lien exists (subsisting or preserved), however no action commenced to enforce lien.	<u>Application</u> to a Judge
2.	Lien action commenced, however no judgment of reference referring lien action to Lien Master.	<u>Motion</u> in the lien action, to a Judge.
3.	Lien action commenced and action referred by judgment to Lien Master.	<u>Motion</u> in the lien action, to the Lien Master.

Whether the proceeding is by way of application or motion, the court requires reliable, first hand affidavit evidence upon which to exercise its discretion. The material must prove one or more of the following:

1. That the premises is an income earning property, *and* that the lien claims may be satisfied out of the income; or

