

An Overview of Construction Liens

(In Five Easy Pieces)

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It is presumptuous, to say the least, to appropriate the title of such a good movie as an introduction to the arcane area of construction liens, and even more presumptuous to think that such a complex area can be summarized in a paper like this without leaving important bits out and unintentionally misleading the reader. But here it is anyway. Like so many seemingly complex matters, the study of construction liens is susceptible to the generous application of Occam's razor, and the Ontario *Construction Lien Act* is no different. The subject is therefore properly approached on the basis of the following five easy principles.

1 - Remember: It's just a statute . . . read it!

Liens for work done on other people's property have existed since the time of Roman law. Most European countries provide for liens in their

civil codes. The lien as a charge against the land to protect the interests of mechanics and suppliers, however, was utterly unknown to the common law. Our common law can be viewed as either a product of or as a basis of market driven economics and society, the result of which often was the sacrifice of the powerless to the interests of the powerful. In North America, at the time of the construction of the White House in Washington D.C. it turns out, it was decided that this "hands off" attitude towards construction credit resulted in the extinction of small business and trades and as a barrier to the healthy growth of a construction industry. Lien legislation was brought into the world as a result, therefore, of an appreciation of the point that market forces and the law of contract are not adequate protections for trades and suppliers.

As a result, liens are entirely creatures of statute. Because statutory liens derogate from the very property rights that common law was instituted to protect, courts have evolved certain principles of interpreting the statute so as to do as little damage as possible to such well entrenched rights. The most important of these principles is the one laid down by the

Supreme Court of Canada in *Clarkson Co. v. Ace Lumber Ltd.*, [1963] S.C.R. 110:

“The lien commonly known as the mechanics' lien was unknown to the common law and owes its existence in Ontario to a series of statutes, the latest of which is R.S.O. 1960, c. 233. It constitutes an abrogation of the common law to the extent that it creates, in the specified circumstances, a charge upon the owner's lands which would not exist but for the Act, and grants to one class of creditors a security or preference not enjoyed by all creditors of the same debtor; accordingly, while the statute may merit a liberal interpretation with respect to the rights it confers upon those to whom it applies, it must be given a strict interpretation in determining whether any lien-claimant is a person to whom a lien is given by it.”

In other words it is a hard door to open and a hard threshold to cross, but it is very pleasant once you are in. So how do you go about opening

that door and crossing that threshold? Simple: you start by reading the legislation. And how do you do that? Simple: by opening the doors of perception and realizing that the statute was not enacted carelessly or randomly; every word from the front cover to the concluding section has meaning and offers insight to the statute.

1. Start with a standard “office consolidation” of the Act. Read the cover. It says that the Act is part of the Revised Statutes of Ontario, 1990, Chapter c. 30. So what? This tells you that the Act is provincial, not federal. So what? The interaction between the provincial *Construction Lien Act* and federal legislation is most material and would be a good subject for a construction lien master class. Try and lien an airport for example, and you will run into this problem. This issue of provincial versus federal legislative competence can really matter in a given case, both substantively and procedurally. You cannot lien Indian reservations, for example, although approximately

\$1.5 billion will be spent on infrastructure in First Nations communities over the next number of years (and high time too; as astonishing as this fact is, many Northern communities exist today without roads, streets, sewers, running water etc.; it was a national disgrace until the federal government very recently applied itself to the task of bringing First Nations infrastructure into the 20th century). Provincially appointed construction lien Masters (as opposed to federally appointed Judges of the Ontario Superior Court) hear and conduct whole trials, much to the relief, it is imagined, of the federally appointed judiciary. All in all the *Construction Lien Act* is a very special piece of provincial legislation.

2. As you cast your eye down the cover of the Office Consolidation that you have before you, you will notice five amendments to the original *Construction Lien Act*, 1983. This tells you that even the legislators, with all of

the resources of the provincial government, could not get it right the first time in such a difficult and complex field. In some ways, therefore, lien legislation must proceed by trial and error. A lot of policy flowing from the very important *Attorney General's Committee Report on the Draft Construction Lien Act*¹ had to be tested in practice before the legislation could be perfected. You would do well to stop reading this paper right now and read the entire 1982 *Attorney General's Committee Report* that preceded and underlies our current legislation. It is a remarkable exposition of the policy considerations behind the legislation, even at a remove of twenty years.

3. The other thing you will notice on the cover of the office consolidation of the statute is a reference to R.R.O. 1990, Reg. 175. This is important. Revised Regulations of Ontario 1990, Regulation 175 is the regulation passed to

¹ Students should purchase and constantly refer to a book published every year by Carswell called the *Annotated Construction Lien Act*. I say this because I am one of the two co-authors of that book and I readily acknowledge that

implement all of the forms used in matters under the Act. Skip to the regulation at the end of the consolidation. Read s. 2 very quickly. What did you notice? You noticed that it said that some forms “may” be used and other forms “shall” be used. This is very important. Most construction lien lawyers overlook this regulation and try to cobble up forms of their own, or do things like serve appointments for cross-examinations without regard to the regulation. This is wrong. This regulation is a gold mine of information about how to use the statute you are about to read. It is only available in English, which is a bit of an interesting construction lien trivia for any of you that are still paying attention.

4. Go back to the cover and turn the page. No one reads the inside cover of the office consolidation, which is a shame. The inside front cover of the office consolidation of the

Construction Lien Act contains a very interesting evidentiary statement: “A document that purports to be printed by the Queen’s Printer for Ontario as an office consolidation of a statute or regulation shall be received in evidence, in the absence of evidence to the contrary as an accurate consolidation of the statute or regulation as it read on the date indicated on the document.”

5. Next, take in the table of contents. I mean, really, take it in. Spend a few minutes reading the table of contents. This table of contents gives you the architecture of the statute and tells you a lot about how it is supposed to work. The table of contents is a very conscious effort on the part of the drafters of the statute to organize their thoughts in a meaningful way. Pay particular attention to the order of the “Parts”, as they are called. The definitions come first in Part I, General. They are vitally important. Some lawyers spend the time to go through

their office consolidation and hi-lite every defined term in the entire statute. It takes a couple of hours to do this, but it is interesting to see places where defined terms are and are not used. It can often be a clue to an interesting argument in a difficult case. The key definitions, like “supply of services” still get litigated on a regular basis. Next comes Part II on Trust Provisions. This is a code within a code, from s. 7 through and including s. 13, that governs the statutory construction trust. This Part is so important that some people say it is all we need. It is so important a book has been written on these seven sections alone.² Once you are “inside” the statute, trust rights and lien rights exist separately and you do not have to have preserved or perfected a lien under the statute to have trust rights, you just have to have made a lienable supply of work, services or materials. Part III is The Lien, and Part IV is Holdbacks. These two Parts work hand in

² This is shameless plug #2 for another one of the author’s books. In this case it is the 1998 Carswell edition of *Construction Trusts*. A second edition is being prepared. So much has happened since 1998 that the first edition, although useful, is fairly out of date.

hand. The lien secures the holdbacks; the holdbacks would be meaningless without the lien, and every exchange of values in a project to which the Act applies is “subject to Part IV” of the Act. Thus, you have another code within a code, this one dealing with preservation of claims against holdback. Part V, Expiry, Preservation and Perfection of Liens; Part VI, Right to Information; and Part VII, Discharge of Preserved or Perfected Liens are a group of sections that can and should be read together and understood as a group. They tell you how liens go on, and how they come off, and what goes on in between. Another code within a code. Then there is Part VIII, Jurisdiction and Procedure. Once again, although it is only a cluster of 18 sections, whole books have been written on the subject.³ The next cluster of sections is comprised of Part IX, Extraordinary Remedies (receivers,

³ Are you keeping track? This is shameless plug #3, this time for the author’s soon to be published Carswell book *Conduct of a Lien Action*. The book actually helps you from “cradle to the grave” in a lien action, so its scope is rather broader than Part VIII alone, but it does deal extensively with that Part. There are other excellent resources, like D. N. Macklem, D. I. Bristow, *Construction Builders’ and Mechanics’ Liens in Canada*, 6th edition (Toronto: Carswell, 1990, looseleaf); H.J. Kirsh. *Kirsh’s Guide to Construction Liens in Ontario*, 2nd edition (Toronto:

bonding companies and the like); Part X, Appeals (none for interlocutory matters, to the Divisional Court in all other cases); and, skipping Part XI for the moment, Part XII, Miscellaneous Rules (costs and such like). This cluster of sections is only for the truly interested student, or some future lien master class. Suffice it to say that lawyers are exposed for costs under these sections, and everyone is directed to keep it cheap and cheerful at all times. Finally, there is Part XI, priorities. The basic principle is that liens have priority over every other interest in land, save and except as set out in the *Construction Lien Act*, s. 78. This is a subject all on its own.⁴

6. Now you are ready to read through the entire statute once, quickly, reading only the bold type headings beside

Butterworths, 1995); K.P. McGuinness, *Construction Lien Remedies in Ontario*, 2nd edition (Toronto: Carswell, 1997)

⁴ Ok, here is shameless plug #4 (I will stop soon): the author has published papers in this area, including the following to which the interested student may wish to refer: D.W. Glaholt, M. Rotterdam, "Deconstructing Construction Liens", in Law Society of Upper Canada, *Special Lectures 2002* (Toronto: De Boo, 2003) at 225.

the various sections. That's right, only the bold type headings for each subsection. The legislators have thoughtfully put explanatory bold type headings into the statute for a reason. They make the best single thumbnail explanation of the statute. If you were really bored, you could write out a list of all of these bold faced headings and they would be a pretty good narrative of what the statute is all about.

7. Now go back and read the Act through, starting at the beginning. After 25 years of reading and re-reading this very small statute, there is always some nuance to be picked up by another close reading.

#2. - Liens arise by the mere doing of work, expire by the mere passage of time, and themselves add absolutely nothing to the value of a project: liens simply preserve and redistribute some of the value to those that created it.

If you can grasp this “second easy piece”, you are well ahead of most people who deal with the Act.

First, a lien is not a registered document it is a legal idea. The registered document is the Claim for Lien, not the lien itself. The lien itself is an inchoate creature of statute that is created in Ontario the very instant that services or materials are supplied to an improvement (s. 14). Once created, a lien subsists thanks to the statute until it expires (s. 31), unless in the meanwhile it is “preserved” before it expires by either registration or “giving” of a strictly compliant Claim for Lien form. Priorities, for example, depend mostly on the value of the land at the time the first lien “arose”, not the time it was registered. Important point. Note it well.

Second, a lien is not magic. It does not magically create value in a situation that has none, it merely preserves whatever value it can for as long as it can. Most people think of a lien as a magic word that transforms insolvent projects into solvent projects. Not so. It does nothing of the kind. At best it protects a mere 10% of the value of the work done, distributed among various classes of persons who together may have many times that amount invested in someone else's project. You will hear the expression "a dime on a dollar" used from time to time to describe a lien. What you are fighting over as a lien claimant is usually 10 cents on every dollar of value added to a project. The only real magic in the Act is found in the trust sections of the statute. I say that because they reach out to capture and bring into the equation money from any source at any time in certain circumstances. This "magic", however, is likely only to last for another few years until everyone finally wakes up to the awesome power of the trust provisions of the Act and changes their accounting so that there is no chance of them ever being liable for breach of trust in the first place. The trust sections of the Act at present have no limitation period, are quasi-criminal in nature, and allow you to reach behind the corporate veil and

recover from officers, directors and persons in control. This is a whole other subject.⁵

In Ontario, a person who supplies services or materials to an improvement for an owner, contractor or subcontractor, has a lien upon the interest of the owner in the premises improved for the “price” of those services or materials. Almost all of the words in the last sentence have a special statutory definition. The lien arises and takes effect when the person first supplies services or materials to the improvement (s. 15). The claim for lien has the following principle benefits:

1. By registering a claim for lien, or even by delivering a written notice of lien, a claimant who has no privity of contract with the owner can cause a usually temporary impediment to the flow of contract funds. This is often thought to be a way of bringing immediate pressure to bear on parties to settle, but this is a myth that should be immediately and thoroughly debunked. It never

⁵ Please see shameless plug #2, above.

happens that way in practice. Unless you are dealing with a first time residential owner, your owner will not be the least bit deterred by the registration of a lien. They will simply exercise their statutory right (underlined because years ago it was a privilege) to place security in court in place of the lien and see the lien claimant rot in hell unless the lien claimant is lucky enough to have counsel that know their way through the Doom-like procedural corridors of the statute. So, do not register a lien to gain bargaining power; register a lien to protect your client's place in line in case of an insolvency. If you are ever teetering on the edge of a decision as to whether to lien or not, lien first and ask questions later.

2. If someone above your client in the construction pyramid is insolvent or even bankrupt, the claim for lien gives the lien claimant the legal right to be paid the holdback monies being held by the owner as a secured and not as a

general creditor. This is a big deal. Should the owner have failed to hold back the appropriate monies, the lien claimant will generally be entitled to cause a sale of the owner's land to pay for the deficiency in the holdback..

3. There are some statutory limits on the value of a lien. Subject to the requirement for the 10% holdback, the value of the subcontractor's lien is limited to the "least amount owed" by the owner to the general contractor in relation to the project. This means that, regardless of the amount owed to the subcontractor by the general contractor, the value of the subcontractor's lien is limited to the amount being held back by the owner. Therefore, there can be a considerable discrepancy between the amount of a subcontractor's claim for lien and the amount actually owed to the subcontractor, if the general contractor owes more to its subtrades than the owner does to the general contractor. This clause exists to

protect owners. The owner's land cannot be encumbered by liens in an amount greater than what the owner owes. If you are a general contractor, on the other hand, your lien will equal the amount owed to you by the owner. In this respect, a general contractor's lien rights are superior to those of its subcontractors.

4. What can be included in a claim for lien? Under the Act, a person is entitled to a lien for "the price of those services or materials" that are provided to the owner's premises. "Price" means, under the Act, the agreed upon price for the services and materials provided under the contract and any approved extras as provided by the contract. If there is no specific price provided by the contract, the lien is for the actual value of the services and materials supplied.

5. Are delay costs lienable? Delayed projects result in extra costs for all parties. Usually the contract or subcontract will provide for a remedy in such a circumstance. The owner is usually protected by a liquidated damages clause. The contractor or subcontractor may wish to lien for costs incurred due to owner's delay. What part, if any, of these additional delay costs can be included in a claim for lien? Are out-of pocket expenses lienable? The cases are divided as to whether additional costs paid for labour and equipment as a result of delay are lienable. Many of the older cases, and some recent ones, state that these are not recoverable costs because they were not contemplated in the contract price. However, some recent cases have leaned the other way. Certainly, you should claim these costs and let the court decide the issues

6. Are lost profits lienable? When a contract is delayed, the claimant inevitably loses profit from the delayed project and the profits he could have made on other jobs. The cases are clear that the contractor or subcontractor cannot lien for these items, in other words, you can not encumber the owner's land with a claim for lost profit. The appropriate remedy is to include your delay claim for lost profit with your lien action, once the lien action is commenced.

7. What material supply gives rise to lien rights? For materials to be lienable, they must become, or be intended to become, a "part of the improvement", or be used directly in the making of the improvement or be used to facilitate directly the making of the improvement. They then must be "supplied" to the improvement. They have to be "placed" on the land

which is being improved or in the immediate vicinity of the project site or land so designated by the owner.

8. What does it mean for equipment to become “a part of” the improvement? This issue is particularly important to manufacturers of prefabricated equipment. It is also important for mechanical and electrical trades that must install this equipment. The general rule is that if equipment can be physically removed from the improvement and re-used elsewhere, the equipment has not been incorporated into the project for the purposes of a claim for lien. A whole pulp mill was once found not to be lienable because someone (presumably a madman) could dismantle the entire multi-million dollar custom fitted thing and send it somewhere else. Each claim, however, must be viewed on its own facts because the court decisions tend to be all over the place on this point.

9. What does it mean for material to be “intended to become part of the improvement”? This provision applies to materials that are delivered to the site but are never made “part of the improvement.” The important thing to remember here is that the material must actually be delivered to the site. Simply manufacturing materials without delivery will not give rise to lien rights. The deliverer must show an “intention” that the materials be incorporated into the project. A recent Ontario Court of Appeal decision found that where a supplier lien claimant was selling material or services without regard to the purpose or site for which the material was destined, it was selling on the credit of the buyer alone and the lien was disallowed. (See *Central Supply Company (1972) Limited v. Modern Tile Supply Company Limited et al.* [2001] 55 O.R. (3d) 783.)

10. What services give rise to mean the contract or subcontract price agreed upon between the services and the construction project. Courts have also asked whether the service enhanced the saleable value of the land. These two approaches are worth to differing results. Project management services on site have been found to be lienable, but not project management services off site. A lien for snow removal has been disallowed but the court held that snow removal that enabled a construction project to take place could be lienable. Engineering and architectural services, estimating work, security services, disposal and excavation work, surveying and commercial clean-up have all been found to be lienable. Each case should be examined carefully on its facts.

#3. - In the end, it's all about holdback.

Well, at least it is partially true to say that it is 'all about holdbacks'. If you put trusts aside for the moment (and it is right to do so because they depend on privity of contract, whereas the whole point of holdbacks is to get around the requirement for privity of contract) it really is all about holdbacks. First, the basics:

1. There are two holdbacks, even though most people tend to talk about the statute as if there was only one. There is a basic holdback (s. 22 (1)) and a finishing holdback (s. 22 (2)).
2. The basic holdback is "equal to" 10% of the "price" of services or materials "as they are actually supplied". This "equal to" formula is particularly interesting. It is a great example of why you have to read the Act closely. It is not the actual cash dollars that matter in the case of holdback, it is an amount "equal to" those actual cash

dollars. This same ingenious formulation is used in the two most powerful sections of the Act, s. 7 (2) and s. 7 (3) (read these sections and the case of *Structural Contracting Ltd. v. Westcola Holdings Inc.* (2000), 2 C.L.R. (3d) 165 (Ont. C.A.)).

3. “Price” is defined (s. 1 (1)) to mean the contract or subcontract price agreed upon between the parties, or, where no specific price has been agreed between them, the “actual value” of those services. The actual value does not always mean what the lien claimant would sell the services or materials for; it just means what they are worth to the improvement.

4. You are likely to hear about another so-called third holdback: “notice holdback”. This is a misnomer. This “notice holdback” is not a holdback at all. It is actually a “retainage” (s. 24 (2)) if you bother to read the statute

carefully. What on earth is the difference between a holdback and a retainage? It is slight, admittedly, but the two terms refer to different concepts. The idea of a “retainage” is also found in the trust sections of the Act. S. 11 allows a trustee under the Act to “retain” from trust funds otherwise payable to beneficiaries “an amount equal” to the amount that it can prove, conclusively, was borrowed or advanced from other non-trust funds to pay legitimate beneficiaries. S. 12 has a similar provision with respect to set-offs. So, when s. 24 (2) speaks about service of notice in writing of a claim for lien, it merely requires the party receiving such a notice to “retain” an amount equal to the amount of the notified claim in addition to the basic holdback. The effect of service of notice in writing of a claim for lien is usually instantaneous, but not irreversible, although a detailed discussion of either point is beyond the scope of this paper. But back to the point: what is the difference

between holdback and a retainage. The material difference is that you cannot set-off against a holdback (s. 30), whereas you can eventually set-off against a retainage, although you have to “retain” until a court can rule on the propriety of the set-off (which is, by the way, reminiscent of another scene from the movie Five Easy Pieces).

5. When a lien is proven, how is the holdback actually paid out, who gets what and why? Every claimant wants to know the “bottom line”. It is by no means a simple question to answer. There is a kind of general principle: the bucket fills from the bottom up. This sounds silly, but it is not really. Lien claimants are organized by the Act into classes, with the remotest class being those with the least degree of privity of contract with the owner, etcetera, right up to the general contractor who has the closest degree of privity with the owner. Once this

sorting process is done, payees get paid before payors in the pyramid, with the result that the little guys get paid first and in full before the big guys see a dime. The persons with the least capacity and means to manage credit risks get paid before the persons that have the most capacity and means. This seems fair. The claims for lien of workers for wages and benefits always get paid first. All members of the same “class” share in the holdback available to that class on a *pro rata* basis.

#4. - Strict compliance with the Act: use it or lose it.

This fourth of our five easy pieces is a lesson usually learned the hard way. People make mistakes. Sometimes they are a wee bit tardy. Sometimes they are a wee bit sloppy. What is the result? Disaster usually.

There is a deceptive section in the Act, s. 6. It is commonly called a “curative section” which is another harmful misnomer held over from the

predecessor section, s. 4 of the *Mechanics' Lien Act*. Anyone that talks about the “curative section” probably is not a very close student of the Act or the cases decided under the Act.

Just read s. 6 for yourself:

Minor Irregularities - No certificate, declaration or claim for lien is invalidated by reason only of a failure to comply strictly with subsection 32(2) or (5), subsection 33(1) or subsection 34(5), unless in the opinion of the court a person has been prejudiced thereby, and then only to the extent of the prejudice suffered.

Like so much of this Act, people make assumptions and it takes the Court of Appeal to dispel those assumptions. This happened in *Structural Contracting Ltd. v. Westcola Holdings Inc.* (2000), 2 C.L.R. (3d) 165 (Ont. C.A.), and it happened for years under s. 6 of the Act. The Ontario Court of Appeal has us all nicely sorted out now and if you practice in the area you know that s. 6 is really an “expiration” section, not a “curative section”. It

requires strict, not substantial compliance with almost all of the provisions of the statute. The exceptions are these:

s. 32(2): Contents of certificate of substantial performance

s. 32(5): Manner of publication of certificate or declaration of substantial performance

s. 33(1): Certificate of completion of subcontract

s. 34(5): Contents of claim for lien

So why do you care? You can always register another lien, right? Wrong. The other important point here is that liens expire by the mere passage of time. If they expire there is simply nothing you can do to bring them back to life. The good news is that no-one's lien expires without their knowing it, or at least having all the means within their own hands to know it. If you don't know when your lien expires, you are being willfully ignorant.

When does your lien expire? It depends on who you are. If you are a “subcontractor”, you must preserve your lien before the happening of the earliest of the following two events:

- a) 45 days following the publication of the certificate of substantial performance in the Daily Commercial News;
- b) 45 days following the last date the person last supplied services or materials to the improvement; and
- c) 45 days following the date the subcontract was certified as complete under s. 33 of the Act (an event that almost never occurs in practice).

If you are a contractor, on the other hand, you must preserve your lien within 45 days of the earlier of:

- a) the date on which a copy of the certificate of substantial performance is published in the Daily Commercial News; and

- b) the date the contract is completed or abandoned.

To preserve the claim for lien, in order to keep it from expiring by virtue of the mere passage of time, the contractor or subcontractor must register a claim for lien in the proper amount and form against the title to the owner's land. If the land belongs to the Provincial Government, or any agency thereof, the claimant must "give" the claim for lien to the person, minister or agency specified by the *Act*. Your lawyer should be consulted if any work has been done on government land or for the government or a government agency. It is a tricky business even for lawyers.

What should the claimant bring to its lawyer to enable him or her to quickly and accurately register the claim for lien?

1. As good a description of the improvement as possible, including the municipal address. This is a problem for material suppliers who may not be aware of the destination of the materials. The best protection is always to require a clear description of the property as a term of any contract.

2. Provide a clear accounting with supporting invoices of the amounts charged and the amounts paid concerning the project. For suppliers with running accounts this may be difficult. They should insure that all invoices and purchases orders show the project for which the suppliers were destined.

3. Provide a copy of the relevant contract which should specify the contract price and a description of the work done.

4. Provide the names and addresses for service of the owner and the general contractor. This can usually be obtained from the prime contract itself.

5. Provide the names and addresses of any persons with an interest in the property other than the registered owner who may have requested that the work be done. The definition of “owner” under the Act is quite broad and includes anyone with an interest in the premises who:
 - i. requested the work; and,

 - ii. upon who’s credit or on who’s behalf, or with who’s consent or for who’s benefit the work was done.

6. Be prepared to give full particulars of the details that make such a person an “owner” under the Act’s definition. This is particularly applicable to a project

performed for a tenant whose landlord is requiring the improvement as a term of the lease.

7. You may be in a bit of a dilemma with respect to work done for a tenant (i.e. such as in a mall). The Act (s. 19) says that if you have any intention of liening the landlord's interest as opposed to the leasehold interest of the tenant, you have to serve the landlord with notice of that fact before the work is done, clearly advising him or her of the improvement to be made. If the landlord fails to disclaim an interest in the improvement in writing in that 15 days, his interest becomes subject to the lien. This never happens in practice. If you claim against an owner when you don't have a claim, be prepared to compensate the owner in costs.

8. Be sure that the persons with signing authority for the corporation, and with knowledge of the project, are

available to discuss the particulars concerning the claim for lien and to execute the claim for lien, affidavit of verification of the lien and registration documentation.

Consulting a lawyer when registering a claim for lien has become all the more important these days because of the transition to electronic registration. The government has mandated that all real property registrations will eventually be done by computer, including claims for lien. Many municipalities have already instituted mandatory e-registration of title documents. In Toronto, at present it is optional, but it will become mandatory within a year. In Durham, Halton, Peel and York e-reg. is mandatory. The statutory provisions that instituted e-registration have made numerous changes to the form of the claim for lien that is to be registered on title. Some of these changes have lead to confusion within the construction law bar and are still being ironed out with the government. Therefore, it is important to consult a lawyer who has some knowledge of construction law when you want to register a lien.

Once the lien is preserved, the next step is “perfecting” the lien. To perfect the lien, the claimant starts an action and, where the claim for lien has not been secured by cash paid into court, a bond or letter of credit, registers a Certificate of Action against the title of the owner’s property. This must be done within 45 days of the last day that the claimant could have registered a claim for lien.

There is the concept (not “option”) of “sheltering” under another lien that is already perfected before the claimant preserves his or her lien or that becomes perfected prior to the expiration of the 45 day period for the perfection of the claimant’s own lien. The sheltered lien does not have to formally commence an action. Sheltering is available as a last ditch remedial measure under the *Act* for small lien claimants but it has severe limitations. For instance, the recent case law states that the sheltered lien is limited to the nature of relief described in the body of the sheltering lien’s statement of claim. If this “relief” concerns work that is totally different from what is described in the trade’s own lien, the trade may not be

properly sheltering. For a mechanical or electrical subcontractor, for example, we would rarely recommend using sheltering.

A subcontractor's lien action should include as defendants the general contractor, the owner and any persons with prior encumbrances on the title to the owner's property. The general contractor should be included for the obvious reason that the subcontractor has a contract with the general contractor and should be suing it for damages for breach of contract. The owner is a party on account of its holdback obligations in relation to the claim for lien. The other parties to the lawsuit are included for the purpose of determining any priority issues (to be discussed briefly later) between parties who have an interest in the owner's property.

What happens after the action is commenced? In Toronto, a claimant usually obtains an order referring the proceedings to a Master, a court official with special knowledge of construction law. All lien claimants for the project must be served with a Notice of Trial in order to have all of these lien actions joined with the referred action for management and

determination by the Master. Once all the lien actions are properly before the Master, examinations for discovery and, if necessary, a trial may occur. The speed with which the lien proceedings move to trial depends on the number of lien claims, the completion of the contract, the complexity of the issues, the sizes of the claims, and the Master's schedule.

Outside of Toronto, practice in lien proceedings can differ markedly between municipalities and therefore the lawyer should investigate the local practice thoroughly with the local registrar.

#5: Use the whole Act, not just the lien bits.

So you have registered a lien. Are you done? I would hope not. The Act contains a wealth of remedies, from demands for information under s. 39, to the right to cross examine other lien claimants on their affidavit under s. 40, to the whole idea of collateral trust proceedings.

Most construction suppliers and subcontractors in Ontario have

traditionally focused on their contract and lien remedies. There is another remedy in Ontario: an action against corporate debtors and their owners for breach of trust under Part II of the *Construction Lien Act*, R.S.O. 1990, Chapter C-30 ("the Act").

There are three principal advantages to this remedy:

1. Liability for breach of trust is often clear. With a few clearly specified and strictly applied statutory exceptions, all participants in the construction pyramid must use project funds to pay their subcontractors and suppliers first before putting these monies to any other use. Even site specific overheads cannot be paid out of progress advances until the trades and suppliers are paid.
2. In the event of a corporate breach of trust, the principals of the company may be personally liable for the

company's breach of trust. The section that gives access to personal assets is remarkably strong and broadly drafted and has been given a large and liberal interpretation by the courts.

3. These trust remedies are available to suppliers and subcontractors even if they have lost their lien rights, and may be exercised in a separate action at the same time or after a lien action. There are as yet no express statutory time limitations in Part II.

The *Act* creates three trusts, but all sorts of other aspects to each exist, nestled into each other like Matrushka dolls:

1. The "owner's trust" (section 7): there are three types of funds that give rise to the owner's trust. First, all amounts "received" by an owner for the purpose of financing the improvement; second, all amounts payable

pursuant to a certificate of payment, and, third, the earned and unpaid portion of the contract price following substantial completion. In each case it is intended that the beneficiary have privity of contract with the owner. The owner is prohibited from using the trust money "for the owner's own use or any use inconsistent with the trust" before the contractor is paid what is owed to it in relation to the improvement. The Ontario Court of Appeal has given recent, resounding affirmation of this important remedy. If and to the extent that the trust attaches, it attaches to whatever money may come into on owner's hands at any time, from any source, including rents.

2. The "contractor's and subcontractor's trust"(section 8): there are two types of funds that give rise to the trust of the contractor or subcontractor: all amounts "owing to" a contractor or subcontractor on account of a contract or

subcontract, whether or not due or payable; and all amounts "received" by a contractor or subcontractor on account of a contract or subcontract. The beneficiaries of this trust are all subcontractors and "other persons" who have supplied services and materials to the project; but, once again, the intention is that a beneficiary has privity of contract with its trustee. The Ontario Superior Court of Justice recently affirmed the necessity of privity of contract to create trust obligations in *1150402 Ontario Inc. v. Delvino*, [2003] O.J. No. 183. The contractor or subcontractor is prohibited from using the trust money for its own use or any use inconsistent with the trust until all beneficiaries are paid all sums owed to them in relation to the improvement.

3. The "vendor's trust:" (section 9): it is technically impossible for an owner to obtain the value of work on its land, sell it, and remove the proceeds from the hands

of the trades. Where an owner sells its interest in the land, an amount equal to the consideration received by the owner less the "reasonable" expenses of the sale and the amount paid to discharge mortgages on the title to the lands constitutes a trust for the benefit of the contractor. There is a similar prohibition on the use of such sums until all trades and suppliers are paid. The beneficiary of the vendor's trust is the contractor.

There is a significant body of case law as to what constitutes breach of these trusts. Some of the conclusions that can be drawn from this body of law are as follows:

1. Any use of trust funds from one project to pay accounts arising from another project or otherwise unrelated to the improvement constitutes a breach of trust;

2. Any use of trust funds to pay for overhead costs, such as rent, head office personnel, payroll, or bank charges constitutes a breach of trust;
3. It is by no means a sure thing that personal bankruptcy will allow you to shrug off trust obligations;
4. If you are loaning money to a construction company you have to be obsessive about properly accounting for the loan advances and repayments on a job by job basis;
5. The New York model is better than ours, because it tells you how not to breach the trust as well as what happens if you do breach it.
6. Any repayment of loans using trust monies will be a breach of trust, unless the borrower can prove that the

very debt repaid was advanced and actually applied to legitimate trust purposes.

The theme running through the cases is that to avoid liability for breach of trust, the owner, contractor and subcontractor should set up and administer a separate bank account for each project. Courts have made it clear that they will not entertain arguments that such a procedure is too costly or too administratively cumbersome. Nor will they entertain arguments that "everyone is doing it" (i.e. commingling trust funds with other monies) as a defense.

The extent to which courts will enforce the trust remedy was made clear in the recent case of *Structural Contractors Ltd. v. Westcola Holdings Inc.* (2000), 48 O.R. (3d) 417 (Ont. C.A.). In this case a commercial landlord owned a four storey office building incorporating an underground parking garage. The landlord contracted with the plaintiff to rehabilitate the garage. It did not obtain special mortgage financing for this project and paid the contractor out of general revenue. Payments to the contractor were by certificate. During and after

certification of payments to the contractor, including substantial performance, the landlord continued to collect rent which it used to pay utilities, property taxes, GST and mortgage charges in the ordinary course of its business. The contractor then sued the landlord corporately and its owner personally, for breach of trust and succeeded against both. The court found that rents received by the landlord after certification of substantial completion were received by the landlord in trust for the unpaid contractor under Section 7(3) of the *Act* and could not be used in the ordinary course of the landlord's business.

There may be some potential difficulties with this result. For instance, if a mortgage cheque was en route to the mortgagee at the time of certification of substantial completion, should the landlord stop payment on the cheque? What would happen to the tenants and the building if the landlord could not pay its ongoing expenses? The owner's trust was held to be strong enough to sweep away all of these objections.

The *Act* gives a trustee certain specific defences to a breach of trust claim; however, these defences have been narrowly and strictly applied.

1. Payments for services and materials supplied to the improvement (section 10): any payment by a trustee to a person whom the trustee is liable to pay for services and materials supplied to the improvement discharges the trust to the extent of the payment. As stated earlier, overhead charges do not constitute services or materials supplied to the improvement. An argument commonly used by contractors who have many ongoing projects is that they have received less from the owner than what they have paid to trades and therefore they must have discharged their trust obligations. This argument has also been uniformly dismissed by the courts. It is no reason to permit such a contractor to retain or divert progress monies. In the end, this defence accrues dollar by dollar as beneficiaries are paid, and in no other way.

2. Retaining trust funds where non-trust funds have been used to pay legitimate trust beneficiaries (section 11(1)): where a trustee pays for services or materials supplied to an improvement out of non-trust money, it may "retain" from trust funds an amount equal to such payment. This only means that the retained amount can be set aside; it cannot be brought into general revenue.
3. Application of trust funds to repay loans used to pay legitimate trust beneficiaries (section 11(2)): where a trustee uses borrowed money to pay for services and materials supplied to an improvement, trust funds can be used to "discharge the loan to the extent that the lender's money was so used by the trustee." Unlike the defence in 2 above, the trustee can actually use trust monies to pay back a loan that was used to pay for work on the project. Therefore, contractors have an incentive to

structure payments to the trades as "loans" obtained from third parties to finance the project. Such loans can therefore be repaid immediately upon receipt of trust monies, if they have been strictly accounted for. Courts have scrutinized this defence carefully. Exact proof is required that the borrowed funds were actually used to pay for work and materials supplied to the specific project. Furthermore it is the trustee who must decide to repay the lender, not the lender itself, after the fact. The loan can also be repaid from trust funds only to the extent that it was used demonstrably for project work. If this onus cannot be met, the defence is disallowed. For instance, in *Ontario Electrical Construction Co. v. S. I. Guttman Ltd.* (1996), 29 C.L.R. (2d) 146 (Ont. Gen. Div.), affirmed (1997), 104 O.C.A. 232 (Ont. C.A.) several loans had been made to a mechanical contracting company that was winding down. The loans were made in order to finish the on-going projects and were made without

differentiating between the projects. The last receivable from the last job was then used to repay the loans, in part. The argument was that since the last job was unprofitable, an amount equal to the shortfall must have come from the loans. The court rejected this argument stating that the trustee had not met the onus of showing that the repaid loans had been used on the job that generated the trust fund.

4. Trustee's defence of set-off (section 12): subject to the requirement to retain the basic holdback, a trustee can also "retain" from trust funds an amount that "is equal to the balance in the trustee's favour of all outstanding debts, claims or damages, whether or not related to the improvement," that are owed to the trustee by the beneficiary or claimed by the trustee against the beneficiary. This defence is broader in some respects than the common law set off defence. At common law a

set off can only be claimed for mutual debts. This means that the set off only applies to debts and only when the parties have debts against each other in the same capacities. Under the Act, there is no requirement of mutuality and the set off can apply to "claims or damages" as well as debts. This is balanced by the significant restriction that the amount set off must be "retained" not spent or otherwise applied. The amount set off cannot be spent until the claim is actually established in court or on consent. Therefore, the trustee has no right to put the set off funds to general use because he or she believes he or she has a set off or will assert one. This principle was confirmed in the 1991 case of *Datasphere Sales Ltd. v. Universal Light & Power Corp.* (1991), 48 C.L.R. 25 (Ont. Gen. Div.). The end result is that a claim, such as a delay claim, that an owner has against a contractor pursuant to the general contract can be asserted by way of set off against money that would

otherwise be paid to the contractor as long as the owner does not spend the money while the claim is being litigated; see *West York Construction (1984) Ltd. v. Walton Place (Scarborough) Inc.*(1997), 35 C.L.R. (2d) 58 (Ont. Gen. Div.).

5. Personal liability applies to the directors, officers, employees, agents, and anyone who has "effective control" of the corporation or its relevant activities, whether or not they have any other capacity. As to what "effective control" means, the statute specifies that the issue is one of fact and that the court may disregard the form of any transaction and the separate corporate existence of any participant.

6. If you are a person to whom section 13 applies, the conduct that attracts liability is assenting to or acquiescing in conduct that was known or reasonably

ought to have been known to amount to a breach of trust by the corporation. This is an after-the-fact, 20/20 hindsight, objective kind of approach, where the court is exercising a supervisory jurisdiction over commercial behaviour.

The standard of knowledge required for liability is an objective one. An officer or director needs to know only those facts about the company's conduct that would lead a person acting reasonably to conclude that the company was in breach of trust. This requires only a general knowledge of the company's financial matters.

Single shareholder corporations are a particular case. A good example is the *Westcola* case. The sole shareholder of the corporation pleaded that no one could have known that paying a landlord's usual expenses from rents in the ordinary course of business could amount to a breach of trust. The *Act* specifies that an order of discharge under the BIA does not release the bankrupt from "any debt or liability arising out

of fraud, embezzlement, misappropriation or defalcation while acting in a fiduciary capacity." This includes breaches of trust.

In the relatively recent non-construction lien case of *Simone v. Daley* (1999), 43 O.R. (3d) 511, the Ontario Court of Appeal stated that not every breach of trust by a trustee falls within section 178(1)(d) of the BIA. The conduct affected by that section, according to the Court, would have to have some element of wrongdoing or improper conduct, such as "a failure to account properly for moneys or property entrusted to the fiduciary in that capacity or inappropriate dealing with such trust property."

The 1999 case of *Toro Aluminum Ltd. v. Revah* (1999), 3 C.L.R. (3d) 1 (Ont. S.C.J.) considered the personal liability provisions of the *Construction Lien Act* in the context of the Court of Appeal decision in *Simone v. Daley*. The Court in *Toro* stated that there may be instances of innocent breach of trust under the *Construction Lien Act* that would be discharged by the BIA. The examples given by the Court were inadvertent payment or accounting error. On the other hand, the Court stated that deliberate misappropriation of trust funds by trustees for

their own use in order to defeat the claim of a beneficiary invoked section 178(1)(d). Between these two extremes, the Court stated that "there is a spectrum of conduct which breaches the CLA, but which may or may not fall within section 178(1)(d) of the *Bankruptcy and Insolvency Act*, depending on the extent to which there was any wrongdoing or improper conduct by the bankrupt in his fiduciary capacity."

No *mens rea* is required under Part II of the Act. Defendants in breach of trust cases have on several occasions raised section 35 of the *Trustee Act* which authorizes the court to excuse breaches of trust where the trustee has nevertheless acted honestly and reasonably. The cases have made it clear that section 35 cannot be relied upon to excuse breaches of trust under the *Construction Lien Act* because to do so would subvert the purpose of the Act, namely to insure that the trust beneficiaries get paid; see *Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd.*, 42 O.R.(3d) 749 (Ont. C.A.). This apparent contradiction between the *Trustee Act* and the BIA in the context of the *Construction Lien Act* trust remedy will have to be resolved by the courts as the trust remedy evolves.

It is also worthwhile to consider the availability of punitive damages in a breach of trust action. Where the conduct of the trustee is malicious and high-handed in disregarding the rights of the trust beneficiaries, arguably punitive damages should be awarded. For example, in *Delfino*, the court awarded \$15,000.00 in punitive damages as a result of fraudulent misappropriation of funds by the trustee.

Conclusion:

This paper has tried to compress a book's worth of learning and practice in to what we humorously entitled "five easy pieces", with apologies to the marvelous movie of the same name. Have we succeeded? Probably not. If we have kept your attention, that is enough. The point is that this is a statute worth knowing, and for its diminutive size it is one of the most powerful commercial statutes in the Province. It is worth knowing and knowing well.