

“I AM OWED MONEY AND I AM NOT BEING PAID. WHAT NOW”

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A. Claims For Lien: What Can They Do For Me?

If you are an unpaid contractor or subcontractor, one of the first remedies that you should consider is the claim for lien. The claim for lien has two main benefits:

“Stay the Hand of the Paymaster”:

- a) By registering a claim for lien, or even by delivering a written notice of lien, the claimant can cause a restriction in the flow of contract funds. This is especially so where the project is being financed on the security of the owner’s land. This will bring immediate pressure to bear.

“Protect the Holdback”:

- b) If the general contractor or owner is insolvent or indeed bankrupt, the claim for lien gives the claimant the right to be paid the holdback monies being held by the owner. 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.

There are several features of a claim for lien under the Ontario Construction Lien Act (“the *Act*”) which all parties in the construction pyramid should be aware of:

1. An owner has two holdback requirements:

- a) The owner must holdback 10% of the services or materials supplied by the general contractor “as they are actually supplied.”
- b) Where the owner has received “written notice of a lien” and has retained in addition to the 10% hold/back further funds (such as funds to cover deficiency work), the owner must hold these further funds to cover the amount of the lien. “The written notice of lien” is a defined term under the *Act*. It is basically any writing served on the owner identifying the premises and the amount of owed. It includes a registered claim for lien.

Concerning the “notice holdback” there is an important consideration. The owner can always set off against the notice holdback claims he might have against the general contractor. These set off claims cannot be made against the basic holdback, so long as the subcontractor have preserved liens against the holdback. The *Act* also says that the owner may set off any claim he might have against the general contractor whether or not these claims pertain to the project. Therefore, subcontractors should not rely heavily on having the “notice holdback” available for payment at the end of the day.

2. Subject to the requirement for the 10% holdback, the value of the subcontractor’s lien is limited by the *Act* to the “least amount owed” by the owner to the general contractor in relation to the project. This means that, regardless of the amount owned 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.

3. 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.

There are a few specific issues that often arise in determining the value of the lien:

a) 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. The key to advancing a successful delay claim is paperwork. Careful documentation of what happened, why and when is crucial. The subcontractor should keep careful records, for example daily journals and logs, and even photographs and video footage so that the cause of the delay and the financial impact the delay had on the subcontractor can be established.

Another key point is to give timely notice that delay has occurred and that the subcontractor will be seeking compensation for the cost of the delay. Failure to give such notice in a timely manner, or especially at all, can be fatal. The terms of the subcontract may set out what is

required notice of a delay claim. Sometimes the terms of the General Contract are incorporated into the subcontract. The standard CCDC-2 form of contract, for example, requires notice of the claim to be delivered to the Consultant within 10 working days after the commencement of delay.

The lesson is to be aware of the requirements of the subcontract and contract that you are working under.

What part, if any, of these additional delay costs can be included in a claim for lien?

Out-of pocket expenses:

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.

Lost profits:

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.

b) What materials give 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. This means that 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.

What does it mean for equipment to be "a part of" the improvement"? This issue is particularly important to manufactures of prefabricated equipment that are to be installed in a building. It is also important for mechanical and electrical trades that must install this equipment. The general rule followed by the courts is that, if equipment can be physically removed from the improvement and can be re-used somewhere else, the equipment will not be viewed as a part of the project for the purposes of a claim for lien. Each claim, however, must be viewed on its own facts because the court decisions differ on this point.

For example, in *Re: A.G. Simpson* (2002) 21 C.L.R. (3d) 50, the judge refused to decide an issue of whether the work formed "part of the improvement" on a summary motion to discharge the lien. A trial was required to decide this issue because it was so dependent on the facts. In this case, the court said that a "robot assembly line", installed and hardwired into

an automotive assembly plant's electrical and mechanical systems may have the necessary permanence to become a "part of the improvement" and give rise to a lien.

What does it mean for material to be "intended to become part of the improvement"? The important thing to remember here is that the person supplying the material must actually deliver it to the site. Just manufacturing materials without such delivery will usually not give rise to lien rights. There is another thing to remember about "intention." The delivering must show an "intention" for the materials to 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.)

c) What services give rise to lien rights?

For services to be lienable there must be a sufficient nexus between the services and the construction project. Courts have also used the standard of whether the service enhanced the value of the land. These two approaches are flexible and have led to differing results. Project management services concerning repairs on site have been found to be lienable, but not project management services off site concerning building permit applications, negotiation with trades, and setting up of sales office. 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.

4. When the lien has been proven, how is the holdback paid out?

Obviously, any claimant wants to know what the monetary "bottom line" is when it goes to the trouble of registering and proving a claim for lien. The "prize" for the lien claimant is the holdback or the proceeds of the sale of the land when the holdback is less than what was required. The following distribution rules apply when liens have been proven in court and the holdback or proceeds of sale of the land are to be distributed:

- i) The claims for lien of workers for wages and benefits always get paid first.
- ii) All other lien claimants are divided into "classes." Those who provided services and materials to the same "payer" (namely the contractor or the subcontractor) form one class.
- iii) All members of the same "class" share in the holdback available to that class on a pro rata basis.
- iv) Liens of a class have priority over the liens of the parties for whom that class provided services and materials.

The same priority rules apply between lien claimants in the event the owner or general contractor become “insolvent” and there is holdback to be distributed or land to be sold.

These rules mean that workers are paid first, the liens of suppliers and sub-subcontractors are paid next, and the liens of the subcontractors follow. The general contractor is paid its portion of the holdback last.

The rules of distribution can result in the lien claimant getting less than 10 % of the contract price.

B. Claims For Lien: How Can I Preserve And Enforce Them?

The subcontractor’s lien arises when it begins working on the project. To “preserve” its lien, the subcontractor must register a claim for lien within one of the following time limitations, which ever one expires first;

- a) 45 days following the publication of the certificate of substantial completion 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.

Similarly a contractor must preserve its 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.

As a result of these time limitations on the preservation of the claim for lien, the contractor and subcontractor must be constantly aware of the state of its accounts when work has ceased at any time during the contract. We generally advise subcontractors that if these accounts remain unpaid, even for less than the usual 30 day payment period stated in the invoice, the subcontractor should contact its lawyer with a view to registering a claim for lien, regardless of any pressure being exerted by the general contractor to the contrary. Otherwise, the general contractor may cease operation and the subcontractor’s lien rights expire.

a) Preserving a Lien:

To preserve the claim for lien, 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 most definitely be consulted if any work has been done on government land or for the government or a government agency.

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

1. Provide a clear description of the municipal address on which the project is taking place. 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:
 - a) requested the work; and,
 - b) upon who's credit or on who's behalf, or with who's consent or for who's benefit the work was done.

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.

6. Concerning work done for a tenant (i.e. such as in a mall) make sure to be aware of s. 19. Under s. 19 you can get a lien attached to the landlord's interest by serving a 15 day written notice on the landlord 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 is then something that you should point out to your lawyer at the time the claim for lien is prepared.

7. 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 and registration documentation.

It is important to consult a lawyer in preparing the lien, because if a mistake is made in the preparation of the lien document, it might not be possible to fix it after the fact. A good example of this can be found in the case of *Williams & Prior Ltd. v. Taskon Construction Ltd.* (2003) 22 C.L.R. (3d) 1. In that case, several liens were registered as a result of work done at a Hugo Boss clothing store in downtown Toronto. Several of the claims for lien named the wrong party as an owner in the claim for lien. The claimants had incorrectly identified the head tenants as “owners”, when the work had in fact been done for a subtenant. The lien claimants tried to argue that the mistake was a technical error, and that the court should correct the mistake for the lien claimants because there was no prejudice to any of the defendants in doing so. The court refused to do so. The whole point of a lien is to encumber an owner’s *interest* in the land. If the owner whose interest is being affected, in this case the subtenant, is not even named in the lien at all, then that is a serious error that goes to the very substance of the lien. It is not a case of failing to comply strictly with the *Act*, it is a failure to comply at all. The court found therefore, that the liens had not been validly registered in time, and discharged them.

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 and most of the Golden Horseshoe, for example Durham, Halton, Peel and York e-reg. is mandatory. By 2007, the entire province is scheduled to be using the e-reg system. 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 led 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.

Finally, construction lien procedure is technical and complex. Make sure that you have hired a lawyer who is familiar not only with the *Construction Lien Act*, but how to prosecute a construction lien claim through the system in the jurisdiction where the lien has been registered. In a recent Ontario lien decision, for example, the Court ordered a lien expired and discharged the lien, where the lawyers had not followed the proper procedure for setting a lien action down for trial in Toronto.

b) Perfecting the Lien:

Once the lien is preserved, the next step is “perfecting” the lien. To perfect the lien, the claimant simply starts an action and, where the claim for lien has not been secured by cash paid into court, a bond or letter of credit, register 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 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 cost saving measure under the *Act* for small lien claimants but it has several 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, the actions are then ordered by the Master to undergo examinations for discovery, if necessary, and trial. 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.

C. Claims For Lien: Lien Security

By serving a written notice of lien, a claimant can seriously interrupt the flow of contract funds. The *Act* has created a facility to avoid these interruptions during the course of the project. The *Act* allows the general contractor to post security in the form of cash, a letter of credit or a lien bond in order to lift the registered lien from the title to the owner’s property. Once the lien has been vacated from title, the notice holdback can be paid by the owner and the project can continue. Liens are vacated by court order and, once the required security has been posted, the liens become a charge against the security.

The following are important points to remember:

- a) The security posted by either the owner or the general contractor is subject to the claims of all lien claimants and will be distributed as if it were the proceeds from the sale of the land. If there are some lien claims that are not secured while others are, the actual sale proceeds generated by those unsecured claims will be “pooled” with

the security for the secured claims to insure that all proven lien claims are treated equally in the end in accordance with the *Act's* distribution rules.

- b) The security posted by the owner to bond off a subcontractor's lien will only secure the holdback obligation of the owner. The security posted by the general contractor will secure the full extent of the subcontractor's lien.
- c) Lien security provides security for the lien claimant's costs up to the lesser of 25% of the lien amount or \$50,000.00. This clearly enhances the lien claimant's position as the lien claim itself does not allow for costs. On the other hand, interest on the debt is neither an amount that can be liened for, nor does it properly form a part of the lien bond security.

D. Further Limitation To A Claim For Lien

Having proven the lien and determined the holdback available for distribution, the claimant rightfully expects to get some money. However, often other parties unrelated to the project will have claims against the holdback in priority to the lien claimants. Two significant parties who often claim priority to the holdback and the proceeds of the sale of the land are mortgagees and Canada Customs and Revenue Agency.

1. Mortgagees

Typically the owner will obtain financing through mortgages. When the land is sold, the proceeds of the sale must be divided between these mortgagees and the lien claimants. The following rules apply in that event:

- i) When a mortgage is taken out for the purpose of financing the construction, all liens have priority over the advances made under that mortgage to the extent of any deficiency in the holdback.
- ii) When a mortgage has not been taken out for the purpose of financing the construction and was registered and fully advanced prior to the commencement of the work, the mortgage has priority to all liens up to the lesser of the value of the property at the time the project work commenced and the amount advanced under the mortgage. This in theory should give the lien claimants access to proceeds corresponding to the increase in value of the land after the work was done.
- iii) Advances made under any mortgages registered prior to the construction have priority to all liens up to the registration of claims for lien. The exception to this is the building mortgage which remains exposed to the deficiency in holdback regardless of when the advances were made.
- iv) Advances made under any mortgage subsequent to the registration of claim for liens are subject to those liens to the extent of the advances.

- v) Any non-building mortgages registered after the commencement of the work are subject to any liens to the extent of any deficiency in the holdback even if the advances were made before the registration of claims for lien. With that exception, any advances made under these mortgages have priority up to registration of claims for lien.

2. Canada Customs and Revenue Agency:

As you know, these days, governments are hungry for revenue. Under the *Income Tax Act* there are provisions which enable CCRA to serve debtors of the general contractor, such as the owner, with notices of garnishment requiring payment of monies owing to the general contractor directly to CCRA on account of taxes that have not been paid by the general contractor. (Of course, this can also occur with respect to a subcontractor that has defaulted on its taxes, and also owes money to sub-subtrades and suppliers.) In several cases wherein CCRA's garnishment has been contested by lien claimants, the courts have held that CCRA has priority to the notice holdback. In some disturbing cases as well, the courts have extended that priority to the basic holdback. Obviously this has caused considerable consternation in the construction industry. Whenever general contractors do not pay their taxes, lien claimants run the considerable risk of having their lien rights rendered meaningless by CCRA. In our experience, however CCRA generally does not attack the basic holdback. Legally, however, there is nothing stopping CCRA from asserting priority even over the holdback.

An open question is whether a CCRA notice should apply only to the principal debt, or whether it can capture interest and penalties too.

Summary

When a subcontractor or contractor is not paid money on the project, the lien remedy should always be considered. However, as you can see there are clear limitations to this remedy and therefore subcontractors should also always seek to uncover any labour and material payment bonds that may exist on the project and all unpaid parties should also take advantage of the trust remedy. A general strategy should be devised with your lawyer in order to maximize the remedies that available.