PROPOSALS FOR IMPROVEMENT

To the Construction Lien Act

By

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I graduated from Osgoode Hall Law School in 1978 and was called to the Bar in 1980. Most of my legal career was devoted to civil litigation. A large part of my practice eventually became construction lien work, in which I acted primarily for smaller subcontractors. Having seen and felt the effects of non-payment to my clients and the failings of the Construction Lien Act to live up to its purpose, I decided to make the following proposals for change.

The object of the Act was to protect persons who supply labour and materials to another person's lands. With chattels, the law had always given to those who improved the chattels a lien over the improvements. Moreover, these liens were given priority over all other interests, including financial securities. With real estate, the concept of a lien was created by legislation, and inevitably, there were clashes from the very beginning with bankruptcy laws and real property laws, especially those involving mortgages and security on land.

In my practice, I have seen small contractors having to close up their businesses, and lose everything they have saved, because of one bad project for which the law did not provide them quick and effective protection. The Act was supposed to do this, but it has failed. It is my profound hope that some of my suggested changes will assist in correcting some of these failures.

DEFINITIONS

1. "contract"; "contractor"; "owner"– the words "the owner" and "the contractor" makes it appear that the Act contemplates only one owner and only one contractor (who is generally in the industry called a "general contractor"). However, in many cases, there is more than one owner and in many cases the owners either hire the trades directly, thus creating many "contractors", or hire a construction manager or project manager who acts as agent for the owners and hires persons on behalf of the owners, again creating multiple "contractors". In a recent case, the Divisional Court has interpreted the priority sections of the Act as applying differently to a person depending on whether he is hired by a construction manager/ project manager, or is hired by a general contractor. If the former, his priority is limited to his own 10% holdback, but if the latter, his priority is shared with all other "contractors" and is to the extent of 10% of the entire improvement. Also in that case the Divisional Court has decided that an "owner" can be an owner within the meaning of the Act, for a small period of time only, and moreover, he is only responsible for any work that was done during that small period of time. It is easy to see how these interpretations can frustrate the purpose of the Act. In the case of Ken Gordon v. Edstan, (1982) CanLii 65, the Ontario Court of Appeal said that if there is more than one owner, they should all be treated as a single owner for the purposes of the Act, and explained that otherwise, there could be erosion of the rights of lien claimants. Similar reasoning should apply to multiple contractors.

construction financing, and the mortgagee insists on hiring a cost consultant to keep track of the amount of work done and insists on holding on to the 10% hold back monies earned by the contractors. Then if the project fails, they claim priority under s. 78 and claim to be entitled to keep this money, because they are not "payers" and so have no obligation to pay this holdback money.

PROPOSAL: I propose that the definition of "payer" be amended as follows:

"payer" means the owner, contractor or subcontractor who is liable to pay for the materials or services supplied to an improvement under a contract or subcontract; but where an owner enters into an agreement with another person that enables that other person to retain monies that the owner owes to a contractor, then for the purpose of such retained monies, that other person shall be deemed to be a "payer" with respect to any such monies retained.

5. Section 6 discusses minor irregularities. It has been held that to get the benefit of the Act, it is necessary to comply strictly with the sections dealing with preservation of liens. I propose that the section be re-worded to remove the reference to specific sections and to replace those words with the words:

any provision in this Act

6. Section 7 deals with trust obligations of owners but is restricted to monies received. In line with the suggestion about the definitions above, I propose that the section refer not only to monies "received" by the owner but also include monies that have been certified as owing by the owner to a contractor that have not been paid to the owner.

7. Section 8 deals with trust obligations of contractors and subcontractors, and makes them the trustee in connection with monies not yet received, but still receivable. It should be clarified that the person from whom the money is receivable is also a trustee of such money.

8. Section 14(2) states that there is no lien for interest owing but that interest can be paid "otherwise". This has been interpreted as meaning that a lien claimant can only get interest from the person that he contracts with. When holdback is available, and the person who should be paying this holdback insists on a trial and insists on contesting the right to pay this holdback, then often it takes a lot of time for the trial and the person is found not to be liable for interest because he did not contract with the lien claimant. This encourages such persons to contest the liens, use the money until forced to pay it by a court judgment, and not have to pay interest. I propose that interest always be payable, by whoever is required to pay money, from the time it ought to have been paid, not as part of the lien, but because money has been withheld and used by that person.

12. S. 44 of the Act deals with vacating liens by posting security. Although s. 44(6) and s. 44(9) at first blush makes it quite clear, in my opinion, that s. 78 no longer applies to the security in court, case law has stated that a mortgagee who pays money into court to vacate a lien can take and sell the lands, free and clear of the liens, and can free up all holdback obligations, and can later come back to court and argue that he still has priority over lien claimants and is entitled to the return of some or all of the money while valid liens remain unpaid. This can seriously erode the rights of lien claimants and must be clarified. I propose that the Rule 2 of s. 44(9) be amended as follows:

Rule 2 – "...to the same extent as if the amount paid into court or security posted was *the net amount realized, after all prior claims to the lands are paid,* by the sale of the premises in an action to enforce the lien and shall be distributed among all lien claimants in accordance with the priorities provided for in section 80, *and the priorities provided for in section 78 shall have no application to this amount paid into court or security posted.* "

13. Another problem with s. 44 is that it has been held that if money is paid out by a mortgagee under his mortgage, but is held in escrow by his lawyer until the lien is removed, then such payment is not considered to be an "advance" within the meaning of s. 78(6). To that extent, it seems fair, but Courts have gone further and said that the money that is paid out can be used to remove the lien under s. 44 and it is still not considered an advance in the face of a lien. This has enabled mortgagees to pay out holdback monies, use it to vacate the liens, and then come back and claim priority to this same money. It should be made clear that the money that is paid out cannot itself be used to remove a lien and still allow the mortgagee to claim that it maintains priority over this payment under s. 78(6).

14. S. 48 of the Act has caused some problems. Many times a lien claimant will try to settle the lien claim, and will agree to payments over time or some other security. If the payer to that lien claimant reneges on the settlement, and the lien claimant has discharged his lien in compliance with the settlement, (because a lender for example will not fund any more until the lien is removed) then the lien claimant loses all rights to the lien. This discourages settlements. I propose that there be available a registration of a Notice of Settlement (and perhaps including the terms of settlement) and that so long as the settlement is in good standing, the lien will be non-effective, but if a lien claimant later registers a Notice of Breach of Settlement, the lien revives from that point, to the extent of any unpaid settlement monies.

15. One of the difficulties that lien litigators have faced is the fact that not many judges understand the Act very well, while at the same time, they are very familiar with the history and theory of real property law and mortgage law. As a result, they tend to misinterpret the Act as not affecting these other real property rights. Masters in Toronto have become expert in the Act, yet they are bound by decisions of Judges. There is a constitutional reason for this. Masters are not s. 96 Judges under the British North America Act. Provinces have gotten around this in other cases by creating specialized tribunals. In construction lien legislation, Ontario got around it by means of a Reference procedure. That is not as good a procedure, because it enables a single reviewing Judge, who may know nothing about