

THE CONSTRUCTION LIEN ACT LIENS AND TRUSTS

OVERVIEW

The Government of Ontario has long recognized that the construction industry is a volatile industry requiring some measure of protection for those companies and individuals supplying labour and materials to job sites. In 1983, the Government enacted the *Construction Lien Act* to replace the *Mechanic's Lien Act*.

The *Construction Lien Act* is a creature of the legislature and creates a procedural scheme designed to have disputes resolved in a more summary fashion than is ordinarily available through the Superior Court of Justice. It allows for those having a direct contract with one another to have their rights and responsibilities defined but also provides rights and responsibilities for those in the construction pyramid, even where a direct contract is not found. The rights and obligations can be separated into two categories:

- 1) holdback / lien rights; and
- 2) trust obligations.

THE LIEN

Section 14(1) provides that 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. The following definitions are found at Section 1 of the *Construction Lien Act*:

“Improvement” means in respect of any land,

- (a) any alteration, addition or repair to the land,
- (b) any construction, erection or installation on the land, including the installation of industrial, mechanical, electrical or other equipment on the land or on any building, structure or works on the land that is essential to the normal or intended use of the land, building, structure or works, or
- (c) the complete or partial demolition or removal of any building, structure or works on the land; (“améliorations”)

“materials” means every kind of movable property,

- 1) that becomes, or is intended to become, part of the improvement, or that is used directly in the making of the improvement, or that is used to facilitate directly the making of the improvement;
- 2) that is equipment rented without an operator for use in the making of the improvement.

“Supply of Services” means any work done or service performed upon or in respect of an improvement, and includes;

- 1) the rental or equipment with an operator; and
- 2) where the making of the planned improvement is not commenced, the supply of a design, plan, drawing or specification that in itself enhances the value of the owner’s interest in the land,

“Person Having a Lien” includes both a lien claimant and a person with an unpreserved lien.

Under the above definitions, as interpreted by the Court, an improvement can include demolition work that “improves the property” and materials can be materials that are delivered to the site intended to be used in the improvement **whether or not** these materials are ever actually used in the improvement. The latest change in the Act also ensures that affixed machinery in a plant such as an automotive assembly plant would fall within the definition of an improvement. Supply of services can include engineering and architectural services or the rental of equipment and has been extended to include the supply of security services to a construction site or the services of estimating and job supervision.^[1]

Section 15 of the *Construction Lien Act* provides that a lien arises and takes effect when a person first supplies services or materials to the improvement. Consequently, at any time after the first supply, a person may proceed to enforce his rights in accordance with the *Construction Lien Act* for the value of services then rendered and for which payment

^[1] G.C. McDonald Supply Ltd. v. Preston Heights Estates Ltd., (1992), 1 C.L.R. (2d) 157 (Ont.Gen.Div.)
Edwards Stephens Associates Limited v. G.L. Trenching Limited (1989) 73 O.R. (2d) 112 (Ont.H.C.)

has not been received. A lien is valid irrespective of whether the moneys under the contract are actually due and payable.

The lien is a claim against the equity or value of the land the owner has and ultimately can be enforced through the forced sale of the owner's interest in the land. The mechanics of the enforcement of a valid lien claim are not the subject of this paper. The first step which a potential lien claimant may wish to consider prior to the actual registration of a Claim for Lien is the provision of a written notice of lien in accordance with the requirements of the *Construction Lien Act*. A "written notice of a lien" is defined as follows:

"Any written notice given by a person having a lien that:

- 1) identifies his payer and identifies the premises, and
- 2) states the amount that the person has not been paid and is owed to the person by the payer."

is a written notice of lien.

Upon receipt of a written notice of lien, the payer, i.e. the person above you in the construction pyramid, must retain the full amount in dispute.

The written notice of a lien is only a temporary measure. In all cases, where the matter is not resolved promptly, the person claiming will have to preserve his lien through the registration of a Claim for Lien in accordance with the forms prescribed by the *Construction Lien Act*. The timeframe within which the claim must be preserved is prescribed by Section 31 of the *Construction Lien Act*. It differs between the contractor (a person having a direct contract with the owner) or subcontractor/supplier. In the case of a contractor, the Claim for Lien must be registered within 45 days of the earliest of the following events:

- the date on which a copy of the Certificate or Declaration of Substantial Performance of the contract is published; or
- the date on which a contract is completed or abandoned.

Accordingly, a contractor can, in some circumstances, be in a position to preserve a Claim for Lien, even though more than 45 days has passed since the date the contractor last physically supplied labour or materials to the improvement. The question of whether or not a contract is completed or abandoned is a question of fact that is open for determination by a trial judge.

Liens of all other persons (subcontractor/suppliers) must be preserved by the registration of a Claim for Lien within 45 days of the earliest of the following events:

- a date on which a copy of the Certificate or Declaration of Substantial Performance of the contract is published;
- the date on which the person last supplied services or materials to the improvement; or
- the date the subcontract is certified to be completed (rarely occurs).

A contract is deemed to be completed for the purposes of the *Construction Lien Act* when the price of completion, correction of a known defect or last supply is not more than the lesser of:

- 1) 1% of the contract price; and
- 2) \$1,000.00.

Those suppliers that supply on an “as-needed basis” (prevenient arrangement) are treated somewhat differently. The definition of “completed” does not apply and, accordingly, the date upon which the 45 days runs is the last supply by a supplier, no matter how small the supply might be.

The actual “preservation” process is now done electronically in most of the province through the Teraview electronic registration system. Although the forms have changed somewhat, the effect is the same.

Once preserved, the lien must be perfected through the issuance of a Statement of Claim and the registration of a Certificate of Action on title to the premises, unless the lien has been “bonded off” before the claim needs to be perfected. The perfection must occur within 45 days of the date on which the Claim for Lien could have last been registered to preserve it. Practically speaking, the prudent lawyer acting for a claimant will perfect a Claim for Lien by issuing a Statement of Claim within 45 days of the date the Claim for Lien was registered.

A Claim for Lien can also be preserved by sheltering under the Claim for Lien of another lien claimant pursuant to Section 36 of the *Construction Lien Act*. A preserved lien is perfected by sheltering where the lien under which it is sheltering is in respect of the same improvement and it either was:

- 1) a subsisting perfected lien at the time when the lien of the lien claimant wishing to shelter was preserved; or

- 2) the lien of the other lien claimant is perfected between the time when the lien of the sheltering lien claimant was preserved and the time when the lien of the sheltering lien claimant would have expired under Section 36(2) of the *Construction Lien Act*.

Those seeking to shelter under another lien claimant's claim should ensure that they have an opinion from a lawyer advising them that their lien has been or can be properly sheltered.

If a lien that was preserved is not perfected properly, it expires and can never be revived.

Section 37 of the *Construction Lien Act* provides that a perfected lien will further expire if the action that has been started to perfect it is not set down for trial within 2 years from the date the lien was perfected.

Once perfected, the lawsuit proceeds in the ordinary way, with minor modifications to the procedures employed in "regular" lawsuits. The lien claimant is protected by the lien for his claim to the holdback, in addition to his direct contract claim with the payor above him in the construction pyramid.

HOLDBACKS

For the specific protection of those not having a direct contract with others above them in the construction pyramid, the *Construction Lien Act* provides a requirement that a basic holdback of 10% be maintained by each and every payor. The balance of 90% of the value of services completed on an improvement can be paid by a payor, without jeopardy, unless the payor has received a written notice of lien or a Claim for Lien.

In the event of receipt of a written notice of lien or Claim for Lien, the payor must maintain a notice holdback, which must be equal to the amount in dispute. It is prudent and recommended for the payor, in those circumstances, to withhold the amount in dispute, plus 25% of the amount in dispute. This amount is chosen as it corresponds to the amount which would have to be paid into Court in accordance with Section 44 of the *Construction Lien Act* in order to vacate the Claim for Lien.

The basic holdback and notice holdback combined will be available to those who prove valid Claims for Lien. The payor, in the event of a default by the person with whom it has a contract, will be entitled to terminate that contract, strictly in accordance with the terms of the contract between the parties, and engage other forces to complete the work. The payor will be entitled to set-off, as against the notice holdback, the completion costs. However, in no event will the payor be entitled to encroach upon the basic holdback in order to complete the work. The basic holdback always remains available to the lien claimants.

The holdback can and will be released once the time for registration of all Claims for

Lien has expired. The *Construction Lien Act* also provides for finishing holdbacks, being again 10% of the value of the work being completed. Finishing holdbacks are for the work completed after the publication of a Certificate of Substantial Performance. Accordingly, a person may register a Claim for Lien against the finishing holdback; however, the work claimed for in the Claim for Lien must be work that was completed after the publication of the Certificate of Substantial Performance. Normally, the holdback on all contracts must await the completion of the entire job and publication of a Certificate of Substantial Completion. However, the *Construction Lien Act* does provide for particular subcontracts to be certified complete. This mechanism exists to allow for early subtrades who have completed their work to have their subcontracts declared complete and their holdback released before the overall job is complete. This mechanism is rarely used in practice.

The *Construction Lien Act* does provide, under Section 28, for an owner or contractor to skip over its subcontractor and pay the lien claimants below the subcontractor directly in certain circumstances. Notice of the intention to make this payment must be made and it is prudent to get agreement of the subcontractor before paying the subcontractor's suppliers or subcontractors below him. Any payment that is made does not reduce the amount of holdback required to be retained under the *Construction Lien Act* and, accordingly, the use of this mechanism is rare.

RIGHTS TO INFORMATION

Pursuant to Section 39 of the *Construction Lien Act*, any person having a lien or who is the beneficiary of a trust (any supplier, subcontractor or contractor) may require, from any owner or contractor, information about the contract, including:

1. The name of the parties to the contract;
2. The contract price;
3. The state of accounts between the owner and the contractor or between the contractor and subcontractor;
4. A copy of any Labour and Material Payment Bond in respect of the contract posted by the contractor with the owner; and
5. A statement as to whether the contract provides in writing that liens that arise expire on a lot by lot basis (residential construction only).

In addition, any subcontractor, contractor or supplier can obtain information from a mortgagee as to whether the mortgage on the premises is a building mortgage and what the state of the mortgage arrears is, if any.

This tool is an important tool to determine whether or not payments have been made and not flowed down to those entitled to them in the construction pyramid. It can also provide valuable information concerning the Labour and Material Payment Bond that might be available to satisfy claims of those who may have missed out on their limitation period for filing a Claim for Lien.

If a person fails to provide information when required to do so by Section 39 of the *Construction Lien Act*, they may be held liable for any damages that result to a claimant. Accordingly, if you are asked for information pursuant to Section 39 of the *Construction Lien Act*, you are obligated to provide it and should consult a lawyer if you have any questions about the extent of your obligations.

ROADS AND STREETS

Section 16 of the *Construction Lien Act*, provides that a lien does not attach to the interest of any person in a public street or highway owned by a municipality. This does not mean that a lien is not possible. A lien can attach to the holdbacks that are required to be maintained by the parties in the construction pyramid. A Claim for Lien may be preserved in the same way as a Claim for Lien against lands in the normal course, except, instead of registering a Claim for Lien, the lien is preserved by delivering a copy of the Claim for Lien to the owner of the lands in question (City or Provincial Government), as well as serving a copy on most other parties in the lien pyramid.

In making a claim for unpaid amounts for services and materials supplied to a road or highway, the same limitation periods apply (45 day periods as set out in Sections 31 and 36 of the ***Construction Lien Act***). The significant difference between a lien on a normal project and one on a highway is that the highway cannot be sold to enforce the payment of the amounts found owing.

A typical area of difficulty involving public streets and highways is when the lands to which services and materials are being supplied are in the process of being initially constructed. The question arises as to whether the lands are truly public streets and highways or whether they can be liened in the normal course and encumbered before being designated highways. Generally, once the subdivision agreement has been registered, the lands are considered public streets and are no longer subject to the registration of a Claim for Lien. The onus to prove that the lands have been dedicated as public streets or highways is on the municipality or provincial government.

If there is any doubt or question, a lien claimant should serve the Claim for Lien as well

as register the Claim for Lien. It is safer to register and err on the side of caution as failure to register when a registration is required means the lien expires and cannot be revived.

GOVERNMENT PROPERTY

There are three levels of government to which services and materials can be supplied:

1. Federal Government/Government of Canada;
2. Provincial Government/ Province of Ontario;
3. Municipalities.

Federal Government Property

Federal Government Property or “Crown Lands” cannot have liens enforced against them. The Federal Government takes the position that the *Construction Lien Act* has no application at all. This is open to debate but the issue has never been conclusively determined by a court. It would be very expensive to test this issue.

Generally, most Federal projects and undertakings are protected by Labour and Material Payment Bonds, which can be utilized by trades and suppliers to obtain payment. This paper will not deal with Labour and Material Payment Bonds.

Provincial Government Property

Provincial Government property, or those lands held by the Provincial “crown”, are subject to the *Construction Lien Act*. The lien is preserved as if the lien were against a public street or highway. It then becomes a charge as against the holdbacks that are required to be maintained. The land is never “sold” to enforce the lien. The Government simply pays the holdback when obliged to do so.

The same time limitations that apply to other liens apply to those relating to Provincial Government lands.

Municipal Government Property

If the lands are not public streets or highways, a lien can be registered against title to lands owned by a municipality and enforced pursuant to the provisions of the *Construction Lien Act*.

When in doubt, the safest method of proceeding is to register a Claim for Lien. The registration of a Release of Lien is easily accomplished in the event that a lien is

improperly registered against “Crown lands”. One can never get a lien back if it has not been registered and should have been registered before the time ran out.

PRIORITY OF LIENS

Sections 78 and 79 deal with the various priorities established by the *Construction Lien Act*. Priorities over mortgages depend upon what the nature of the mortgage is and when it was registered. The following rules apply generally to mortgages:

1. Liens arising from an improvement have priority over all mortgages or other agreements affecting the owner’s interest in the premises, except as provided below:
 - 1) mortgages registered before a lien arises have priority to the extent of amounts advanced under the mortgage, provided those amounts are equal to or less than the actual value of the land at the time the first lien arose. A lien first arises when a person commences work on the improvement;
 - 2) where a mortgage is registered before a lien arises and advances are made after a lien arises, the mortgage will retain its priority until a lien is registered or until the mortgagee receives written notice of a lien. However, the mortgage loses its priority to the extent of any deficiency in the owner’s 10% holdback, whether or not the lien has been registered or written notice of lien has been received by the mortgagee;
 - 3) in the event that the mortgage is a “building mortgage” (a mortgage is a building mortgage when it is taken with the intention to secure the financing of the improvement), then all liens relating to the improvement will have priority over this building mortgage, regardless of when the mortgage is registered, to the extent of any deficiency in the holdback to be maintained by the owner.

Priority of Liens over Executions:

Liens arising from an improvement have priority over all Judgments, executions, assignments, attachments, garnishments and Receiving Orders recovered, issued or made after the lien arises.

Priority Among Lien Holders:

Sections 79, 80 and 81 of the *Construction Lien Act* provides the priority among lien holders. Generally, all claimants of the same class rank equally with respect to any

funds available for distribution to that class. Those lower in the pyramid have priority over those higher up in the pyramid and wage earners are given a super priority for wages to the extent of 40 regular working days.

Liens also have priority over any mortgage that may be given to a lien holder in payment of or as security of its Claim for Lien. Accordingly, taking a mortgage in exchange for a Release of Lien can be a dangerous way of proceeding.

Generally speaking, lien claimants have a secured claim against the holdback, which survives bankruptcy of the payor above them. The failure of the owner to make payment of the holdback will give rise to a right in the lien claimant to sell the owner's interest in the land to satisfy the owner's obligations.

LEASED PREMISES

Where labour and materials are supplied to a tenant, the tenant is considered an owner under the *Construction Lien Act*. However, the tenant owns the leasehold interest.

If a contractor, subcontractor or supplier wishes to have the interest of the landlord subject to the lien, the contractor, subcontractor or supplier must provide written notice to the landlord before supplying to the improvement in accordance with Section 19 of the *Construction Lien Act*. This is rarely done.

The landlord may choose, upon receiving such a notice, to respond by declining to have his interest encumbered by the lien. This would then leave the lien claimant having only its remedies against the leasehold interest.

Practically, a lien against a leasehold interest is almost never very good security for the lien claimant. If the tenant goes bankrupt or becomes insolvent, the landlord can collapse the lease and the lien holder has no claim against the property. If the tenant is not insolvent, the lien provides very little further protection for the lien claimant as selling a leasehold interest on the market is a difficult, if not impossible, enterprise.

Accordingly, when in doubt about whether or not you are supplying to a leasehold interest, you should find out prior to supplying and attempt to get the landlord "hooked" through the provision of a Section 19 notice.

TRUST PROVISIONS

The Trust Fund

Part II of the *Construction Lien Act*, pursuant to its Sections 7 to 13, provides for a trust to be impressed on all funds intended for payment of an improvement coming from the

owner to the contractor, to subcontractors and down the construction pyramid. It provides such a trust fund primarily to prevent those most in need of protection, namely contractors and subcontractors, from being victimized by unscrupulous payers. As a safeguard, all moneys received by the contractor or held by the owner for the payment of persons having contributed to the improvement constitute a trust fund in its hands for the benefit of those persons. Until all of those persons have been paid in full, the owner or the contractor, acting as the trustee, must not appropriate or convert any part of the trust funds for its own use or any use not authorized by the *Construction Lien Act*.

The *Construction Lien Act* provides for a statutory trust, creating a fiduciary relationship between the trustee (i.e. the owner, contractor or subcontractor, as the case may be) and the beneficiaries of the trust funds (i.e. persons who have supplied services or materials to a particular construction project). The *Construction Lien Act* seeks to allow the proper payments in and out of the trust fund in order facilitate the flow of funds on the project. The *Construction Lien Act* also defines the extent of the beneficiaries' rights, trustee's duties and precisely when a trust is created.

The Time at Which the Trust Arises:

Under Section 8(1) of the *Construction Lien Act*, funds owing to a contractor or subcontractor whether or not due and payable or funds received by a contractor or subcontractor are impressed with a trust. A trust arises as soon as the money becomes owing to the trustee, be it the contractor or the owner. Obviously, when the moneys are in the hands of the contractor, they have been received. The problem often arises during the period prior to the contractor taking physical possession of the moneys and the determination of when exactly the moneys are due and payable. Section 8(1) creates a trust for the benefit of its subcontractors and all subcontractors who have supplied services or materials on a particular construction project. The trust remains in effect at each level of the pyramid for the benefit of each class of sub-subcontractors supplying services or materials to the improvement.

There are six different types of trusts that can be created by the *Construction Lien Act*. They are:

- Mortgage Trust;
- Certificate Trust;
- Substantial Performance Trust;
- Draws Trust;
- Purchaser's Trust; and
- Vendor's Trust.

Mortgage Trust:

The Mortgage Trust is created by Section 7(1) of the *Construction Lien Act*. This section provides that all moneys received by an owner, excluding the Crown or a municipality, to be used in the financing of an improvement, usually under the form of a building mortgage, constitutes a trust fund for the benefit of the contractor providing that it can show privity of contract between it and the owner.

Contrary to other trust funds described below, this trust fund can be used to pay for the land that will be subject to improvements and pay for other encumbrances such as other mortgages and liens already on title. In addition, the Mortgage Trust arises only when the owner actually receives the money from the building mortgage contrary to a trust created under Section 8(1), where a trust is created when the funds are simply due and payable.

Certificate Trust

The Certificate Trust is created by Section 7(2) of the *Construction Lien Act*. On most construction projects, the owner will engage the services of an architect or an engineer to prepare plans and specifications and to supervise the construction. In order to facilitate the flow of payments down the construction pyramid from the owner to contractor to subcontractors to sub-subcontractors, the architect/engineer may issue certificates from time to time certifying what work was completed and placing a dollar value on that work. The amount certified by this certificate constitutes a trust fund for the benefit of the contractor providing that the money is actually in the owner's hands or received by the owner after the certification.

Substantial Performance Trust

The Substantial Performance Trust is created pursuant to Section 7(3) of the *Construction Lien Act*. This trust is only created where substantial performance of the contract has been certified under Section 32(1) of the *Construction Lien Act*. Where the owner has only made part payment of the certified amount to the contractor, the unpaid portion constitutes a trust providing that the funds are in the owner's hands or that the owner received the funds following the certification. This particular trust is designed to deal with the situations where the contract does not provide for the issuance of progress certificates as described in the Certificate Trust and cases where the payments made by the owner to the contractor total less than the amount ultimately certified to be due and owing at the date of substantial performance.

Draws Trust

The Draws Trust is created pursuant to Section 8(1). This section provides that the funds owing on account of the contract or subcontract, constitute a trust fund for the benefit of the subcontractors and any other persons who have supplied services or

materials to the improvement. Section 8(1) also allows that in the event that a contractor or an owner acting as trustee becomes bankrupt at the time when moneys are in its hands, those moneys do not fall into its estate but rather constitute a trust for the trust fund beneficiaries.

Purchaser's Trust

This trust arises particularly in situations involving the construction of a new house. It is not uncommon for a developer/owner to conclude a sale before all the subtrades have completed their work and before they have been completely paid. Where by his conduct, it can be implied that the purchaser has given the trades assurances of payment or where he has purchased the house built in accordance with a sample or model, then that purchaser can be deemed the statutory owner and a trustee under the *Construction Lien Act*. Barring the above representations, the purchaser does not have any fiduciary obligations to the unpaid trades.

Vendor's Trust

To offset the inequities described above in the Purchaser's Trust, the Vendor's Trust is created pursuant to Section 9(1) of the *Construction Lien Act*. When an owner sells his or her interest in the premises, the proceeds received as a result of this sale are impressed with a trust for the benefit of the beneficiaries (contractor or sub-contractor). This is called the Vendor's Trust.

Moneys not Subject to the Trust

Moneys that are received by a contractor from a subcontractor by way of compensation as a result of it not complying with its contract, are not considered trust funds within the meaning of the *Construction Lien Act* as the moneys are not received pursuant to a contract for improvement.

Where the subcontractor sold materials to a contractor for an improvement done on land in another province, the moneys received are not impressed with a trust since the *Construction Lien Act* applies only to lands within the province.

In the event a contract deals with work that falls under the *Construction Lien Act* and work that does not, it is only the amount of the contract relating to the materials coming within the *Construction Lien Act* that is subject to the trust.

The *Construction Lien Act* only impresses with a trust, funds that constitute payment for materials and/or supply of improvements on land. Land as defined by Section 1 of the *Construction Lien Act* excludes work related to chattels. In other words, anything that is detachable from the land is excluded from the *Construction Lien Act*. For example, the Court found that proceeds of the sale of portable schoolrooms were not subject to the trust provisions of the *Construction Lien Act* as these schoolrooms were not affixed to

the land. Consequently, the work performed did not constitute an improvement within the terms of the *Construction Lien Act* and the funds were not impressed with a trust.

OBLIGATIONS OF A TRUSTEE:

Until the beneficiaries of a trust are paid in full, all trust funds may not be appropriated or converted by the trustee, be it the owner or contractor for its own use or for any use not authorized by the trust provisions of the *Construction Lien Act*. This is so pursuant to Section 7(4), in the case of the owner, and pursuant to Section 8(2), in the case of a contractor or subcontractor.

An owner is in breach of the trust where, for example, he or she uses moneys advanced under a building mortgage on project A to pay trades working on project B or where a contractor uses trust moneys received by the owner to reduce its personal bank indebtedness unrelated to the project.

Pursuant to Section 10, the trust and the trustee are discharged from all liability when all the funds received by them or all amounts due and payable have been paid to all persons who have supplied services or materials to the improvement. However, Section 11(1) allows a trustee to retain trust funds to reimburse all funds it paid from non-trust funds for services and materials for the improvement. Similarly, Section 11(2) provides that a trustee may use trust funds to repay non-trust moneys loaned to it so long as the borrowed moneys were applied towards the improvement.

THE RIGHT TO SET-OFF FROM TRUST FUNDS:

The Courts have interpreted the *Construction Lien Act* as requiring a proper accounting to be had between the trustee and those who have contracts with it, so as to determine the correct amount due, owing and payable from the trust funds. The determined amount then becomes the trust fund.

Notwithstanding the trustee's obligations to preserve that trust fund, Section 12 of the *Construction Lien Act* provides that a trustee may set-off all outstanding debts, claims or damages, whether they are or are not related to the improvement, against any amount it owes the beneficiaries of the trust.

The Ontario Court of Appeal has broadly defined the amount owing to the trustee as being the contract price, less costs of completion, less any outstanding accounts in favour of the trustee against the beneficiary, less damages, if any, awarded to the trustee for the delay in completion and less past payments by the trustee to the beneficiary. In short, a set-off can be defined as encompassing any money owed to the trustee by the beneficiary.

In the event of a possible set-off, the trustee must continue to preserve the trust funds until the amount of its claim for set-off has been determined. The trustee cannot speculate as to the possible set-off as justification for using the trust funds for other purposes. Further, pursuant to Section 12, where a trustee claims a set-off as against the trust fund due to indebtedness of the beneficiaries, the Courts have found that the *Construction Lien Act* does not allow the trustee to unilaterally determine what ought to be held in trust and spend the difference, but rather he must retain the entire trust fund until the ultimate arithmetical calculations determine what part of that trust fund can be spent in light of the trustee's set-off.

As discussed above, Sections 11(1) and 11(2) permit the trustee to pay himself back and pay off loans for funds used on the improvement. In certain cases, the Courts have held that Section 11(2) does not apply unless the contractor actually elects to make repayment to the lender. For example, the Court has held that in the event a contractor becomes insolvent and there are moneys owed to the bank for loans obtained for the improvement and moneys owed to subtrades, the bank does not have first priority over the moneys unless that contractor has elected to pay the bank instead of the subtrades. Section 11 only allows the trustee to repay loans or indebtedness incurred for the improvement without being in breach of trust, but failing a clear intent of the trustee to do so, the trust fund remains the entitlement of the trust beneficiaries.

Further, the Courts have held that creditors of the trustee cannot benefit from Section 11 unless all of the money granted to the trustee was used on the same project, being the project that is the subject of the dispute. Therefore, in a case where the trustee is operating a general line of credit to fund several projects, the trustee cannot repay this line of credit with the trust funds from one specific project.

In a case where the contractor abandoned the project prior to its completion, the Court held that it was not a breach of trust for the owner to set-off the cost of completing the work and use the trust funds to complete the abandoned project.

Where the owner or the contractor claims an accounting by way of set-off or counterclaim, it bears the burden of proving that it is entitled to the set-off as the trust provisions provide, *prima facie*, the beneficiaries the benefit of the trust fund. Frequently, this type of claim arises by virtue of the contractor having failed to complete its contract or caused delay in the completion of the project. In many cases, the Courts have found that, notwithstanding that the money owing to the trustee was not related to the project, the trustee had met the burden of proof in showing a right to set-off.

Finally, any payment of the holdback to lien claimants is a discharge of the trust obligations of the trustee to the extent of the payment made. Section 30 of the *Construction Lien Act* prohibits the trustee from claiming any set-off against the

holdback funds until all the liens that may be claimed against the holdback have expired as provided in Part 5 of the *Construction Lien Act*, been satisfied, discharged or payment has been made into Court.

The trust obligations are discharged once the holdback has been paid to the lien claimants and the remainder, if any, has been either paid in accordance with the trust to further trust claimants or has been the subject of a proper set-off as discussed earlier in this paper. Accordingly, the lien claimants are significantly better protected in the case of a trustee claiming rights to set-off against the trust funds ordinarily available to both lien claimants and other trust beneficiaries.

Personal Liability of Officers, Directors or Controlling Minds

Section 13(1) of the *Act* contains special provisions that effectively “pierce the corporate veil” and hold the officers, directors and controlling minds of a Corporation personally liable for any breach of trust committed by the Corporation under the *Act*. The officer, director or controlling mind who assents to, acquiesces in or participates in conduct that he or she knows, or reasonably ought to know, amounts to a breach of trust by the Corporation can be, and often is, held liable for breach of trust.

What constitutes effective control of a Corporation for purposes of establishing liability is a question of fact. The Court will not hesitate to look beyond the form of a transaction and look at its effect to “pierce the corporate veil”. Individuals have been held liable in numerous circumstances.

Where several individuals are liable for the same breach of trust, each individual is entitled to recover contributions from any other liable person so there is an equal contribution by all parties liable for the breach of trust.

It is important to note that, for the Defendant Trustee Contractor to be liable, intent is irrelevant. It is not necessary for the trust claimant to show any fraudulent activity on the part of the Defendant. Merely standing by and allowing the Corporation to commit a breach of trust can be sufficient for the individuals behind the Corporation to be held liable.

In conclusion, the *Construction Lien Act* has two important categories of rights and obligations associated with it. These are the lien rights and the trust obligations, both of which can be looked to to provide relief to a contractor, sub-contractor or supplier who may be left unpaid on a project.

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