Manitoba Law Reform Commission

THE BUILDERS' LIENS ACT: A MODERNIZED APPROACH

Consultation Paper

February 2018

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REQUEST FOR COMMENTS

Comments on this Report for Consultation should reach the Manitoba Law Reform Commission ("MLRC") by **April 2, 2018.**

This Consultation Paper identifies 46 Issues for Discussion relevant to reform of Manitoba's *Builders' Liens Act*. Clarification and modernization of this Act is contemplated together with the introduction of provisions intended to promote prompt payment down the construction contract chain.

The Issues for Discussion are phrased as open-ended questions for consideration and response by all stakeholders, meaning lawyers, contractors, subcontractors, suppliers, construction industry associations, professional advisors, bonding companies, financial institutions, owner groups, and others who rely upon or are impacted by the special remedies provided in the Act and the possibility of prompt payment reforms to the Act ("Stakeholders"). The MLRC encourages you to provide your thoughts, comments and suggestions concerning this aspect of Manitoba's law. Please identify each Issue for Discussion on which you wish to make comment and clearly identify any other matters you think should be addressed. The MLRC invites you to describe how each issue might affect your participation in or with Manitoba's construction industry. Responses will be considered by the MLRC when developing its final recommendations.

Written submissions may be provided in hard copy or in electronic format and should not exceed 25 pages in length double spaced.

Please submit your comments in writing by email, fax or regular mail to:

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The MLRC assumes that written comments are not confidential. You may submit anonymous written comments, or you may identify yourself but request that your comments be treated confidentially. If you do not comment anonymously, or request confidentiality, the MLRC may quote from or refer to your comments in its Final Report.

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ACKNOWLEDGMENTS

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This Consultation Report was prepared with the extensive support of Betty Johnstone, the Commission's consultant on this project. The Commission is also thankful to those who have provided their time and assistance to this project to date and who will be properly acknowledged in the Commission's Final Report.

The contents of this Consultation Paper are presented for informational purposes intending to generate discussion for effective reform and do not necessarily represent the views of those who have so generously assisted the Commission in this project.

EXECUTIVE SUMMARY

Builders' liens and **trusts**, which are the statutory remedies provided to the construction industry in *The Builders' Liens Act*[1] (the "Act" or the "Manitoba Act"), have long been relied upon in Manitoba by owners and financiers of construction projects as well as contractors, sub-contractors and suppliers of construction materials. The fundamental purpose of the Act, along with its predecessor Acts, is to ensure that a person contributing to the improvement of land is paid for that contribution in accordance with his contractual entitlement.[2]

In June 2017, the Manitoba Law Reform Commission ("MLRC") commenced a project for review of the Act. The review was triggered by a number of factors:

- the long period since the current Act was introduced in 1981;
- judicial criticisms respecting gaps and uncertain legislative intention within the Act;
- local and national efforts to promote prompt payment legislation; and
- recent amendments to Ontario's comparable legislation following the issuance on April 30, 2016 of a report commissioned by the Attorney General and Ministry of Economic Development, Employment and Infrastructure of that Province entitled "Striking the Balance: Expert Review of Ontario's Construction Lien Act"[3] (the "Ontario Report").

The objective of this Consultation Paper is to solicit comments from those in Manitoba most affected by construction industry legislation. Options for reform of the Act are provided together with discussion of relevant legal principles and observations respecting usual industry practices. Stakeholder responses to this Consultation Paper will influence formulation by the MLRC of its final recommendations to be published in its final report and submitted to the Minister of Justice at the end of the project.

In undertaking this project, the MLRC recognizes that various segments of the construction law industry have varying and often competing interests. In undertaking this project, the MLRC's purpose is not to favor one group or segment of the industry over any other but to conduct a comprehensive review of the legislative history of Manitoba's construction lien legislation, including consideration of the purpose of liens and trusts within the industry, identify and analyze issues with the legislative scheme as it currently stands, and develop recommendations that modernize the laws impacting Manitoba's construction industry.

There are seven (7) Chapters in this Consultation Paper. The Paper identifies 46 Issues for Discussion which are clearly identified throughout the text.

[1] RSM 1987 c B91.
[2] Manitoba Law Reform Commission, Report on Mechanics' Liens Legislation in Manitoba (Report #32) (Winnipeg: Manitoba Law Reform Commission, 1979). [Manitoba Report, 1979].
[3] Reynolds, Bruce and Sharon Vogel, "Striking the Balance: Expert Review of Ontario's Construction Lien Act" Independent Report to the Ministry of the Attorney General. (Toronto: Ministry of the Attorney General, Ministry of Economic Development, Employment)(30 April 2016) [Ontario Report].

CHAPTER 1- BACKGROUND

The Builders' Liens Act of Manitoba includes two distinct legislative schemes for the benefit of persons involved in the construction industry: lien provisions and trust provisions.

1. History and Purpose of Lien Legislation

Lien provisions provide the right to claim and enforce liens based upon the cost of work, services or materials provided to improve the value of an owner's land.

The legal origin of builders' liens (sometimes called mechanics or construction liens) is Roman law – the law of European countries governed by the Civil Code. Historically, the law of England contained no such provision and does not to this date.[4]

Due to their colonial connections with European countries, the Province of Quebec and the American state of Louisiana operate under laws based upon the Roman Civil Code. All other Canadian provinces and territories and American states operate under laws based upon English common law principles.

In 1791, the common law state of Maryland was the first in North America to introduce lien legislation modelled on Roman law principles.[5] All common law jurisdictions of North America followed suit. The first such acts to come into force in Canada were enacted in Ontario and Manitoba in 1873. Because there is no right to a lien upon land in favour of persons performing work, providing services or materials either at common law or in equity, the lien is entirely a creature of statute.[6]

Such acts have been found to be primarily concerned with the commercial interests of persons who contribute work, services or materials to the improvement of real property, whether by a contractor under contract with the owner or by any sub-contractor or supplier, with **the primary purpose** of better enabling such persons to recover the amounts owing to them. Such remedial statutes have also been found to have a **secondary purpose** of ensuring business efficacy by protecting the commercial interests of others, including the owner and financier of the improvement, to allow project funds to flow through the contractual chain while managing the risk to lenders and owners for liability to those providing the work, services or materials.[7]

[4] See Latham, Michael, "Constructing the Team, Final Report of the Government/Industry Review of Procurement and Contractual Arrangements in the United Kingdom Construction Industry", HMSO, Department of the Environment, 1994, cited in Bristow, David et al, *Construction, Builders' and Mechanics' Liens in Canada*, loose-leaf, 7th ed (Toronto: Carswell, 2005), at footnote 3 at 1-3 [Bristow].
[5] Ibid, at 1-3.
[6] Ibid. See also *Johnson v. Crew*, [1835] OJ No 74 5, UCQB (OS) 200(CA) at 6.
[7] *Town-N-Country Plumbing & Heating (1985) Ltd. et al. v. Schmidt et al*., 93 Sask R 278, 1991 CanLII 7989 (SK CA), s 27, rev. on other grounds in [1989] SJ No 486.

General Nature of the Lien

Liens arise when the claimant commences work, provides services or provides materials for the improvement of the owner's land.[8] In Manitoba, a lien may charge not only the owner's land, but also the money retained as holdback.[9]

The value of a claimant's lien fluctuates with the unpaid value of its completed work. In its unregistered state, the lien has been usefully described as follows:

> ...the lien subsists as an "inchoate" statutory security, the effect of which is to collateralize the credit advanced by contractors and/or subcontractors and suppliers... [whether or not they have a contract with the owner of the property].[10]

The existence of an unregistered lien is time-limited by the statutes which create them so that builders' liens automatically expire unless specified steps are taken within time periods allowed for 'fixing' or crystallizing the accrued inchoate or floating charge. Usually a lien is fixed by registration against title to the land, or, where Crown lands are at issue, by giving written notice of the claim for lien as required by the Act.

The permitted time for registration or serving notice of a claim for lien in Manitoba is forty days from the earliest of certain events, such as completion or abandonment of the contract under which the lien arises, last date of material supply or issuance of a certificate of substantial performance as the project nears completion.[11]

Effect of Lien Registration

Not only does registration of a lien against land 'fix' and quantify the amount of a claim for lien at that time, but the Act also cautions that mortgage advances and all payments on the construction project in question must be suspended in the face of a registered lien. Sometimes this effect is referred to as 'staying the hand of the paymaster'.[12] Failure to suspend advances or payments results in the lender losing priority for such advances and the owner risks liability for double payment of amounts paid out in face of a registered claim for lien.[13]

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[8] *supra*, note 1 at s 13.
[9] Ibid at s 13 & s 26.
[10] Bristow, *supra* note 4, at 1-1 & 1-2.
[11] *supra*, note 1 at s 43 & s 44.
[12] See, for example, in *Craig v. Cromwell*, (1900), 27 OAR 585 (ONCA) at 10; *Dziadus et al. v. Sloan et al.*, 51 Man R 236, [1944] 1 DLR 65 at 11.
[13] *supra* note 1 at ss 27(1),(2)&(3), s 31, see also: *South Westman Regional Health Authority Inc. v. Accurate Dorwin Co*., 2001 MBCA 127, [2001] MJ No 327 whereby double payment was ordered for the value of the lien registered when the owner proceeded to pay out.

Statutory Relief from the Commercial Effect of Lien Registration

Section 55(2) was added to the Act to allow an incomplete construction project to proceed after one or more liens have been registered:

> **Vacating lien on payment into court, etc.**
>
> 55(2) Upon application, a judge may order security or payment into court in an amount equal to the holdback required under this Act as it applies to a particular contract and any additional money payable with respect to that contract but not yet paid but not exceeding the total amount of the claims for liens then registered against a parcel of land and may then order that the registration of those liens be vacated.

The provision allows an application to be made to Manitoba's Court of Queen's Bench for an order vacating the lien(s) registered. Upon the posting of security by the applicant (usually the contractor, but sometimes the owner) in an amount described in the Act, the Court may order that the registered lien(s) be discharged by the Registrar in the applicable Land Titles Office, and the security posted then stands in place of the land, subject to a first charge in favour of the claimant(s) whose lien(s) has/have been vacated.[14]

Enforcement of Lien Claims

Only liens duly registered or for which notice has been given can be enforced.[15] Strict compliance with the statutory requirements for registration or giving notice of a claim for lien must be proven to establish that a lien is valid and enforceable. To prove a claim for lien, the claimant must issue a statement of claim upon commencing an action in the Court of Queen's Bench. Unless an action is commenced within two years of the date of registration, and a pending litigation order is registered, the lien will expire.[16] This two year requirement applies whether the claimant seeks to enforce its claim against land or against security posted to vacate its lien under section 55 of the Act.[17]

The Role for Statutory Holdback

The Legislature has capped an owner's potential liability to lien claimants by creating provisions involving retention of a holdback from contract price amounts payable. In Manitoba, the holdback is equal to 7.5% of each payment made on account of the contract price.[18] If an owner complies with the requirement to deduct and retain holdback according to the Act, it can limit its monetary exposure to lien claims in the event of a payment default by others on the project.[19]

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[14] *supra* note 1 at s 56(1).
[15] Ibid at s 41(3).
[16] Ibid at s 49(2) & (4).
[17] Ibid at s 51 & s 56.
[18] Ibid at s 24(1).
[19] Ibid at s 27(1).

Peculiarity of Lien Rights

Lien rights are fragile in nature. They are quick to expire and cannot be resurrected if not acted upon in a timely and compliant manner. Because the legislation creating them is remedial and derogates from the common law context in which they exist, the technical requirements set out for proper exercise of such rights are strictly construed by the courts. Once a claimant proves that it is a person intended to benefit from the Act and that it has properly exercised its statutory right of lien, interpretation of the Act to determine a qualified claimant's rights of recovery may be more liberally construed.[20]

2. History and Purpose of Trust Provisions

The second distinct set of legislative provisions found in the Act for the benefit of persons involved in the construction industry involve statutory trusts. Unlike builders' liens, which owe their existence to the Roman Civil Code and a legal system quite different from the English system of common law, trusts originated as an equitable construct in the English courts of Chancery and continue to be an integral part of the English system of common law.

In 1883, Manitoba enacted *The Payment of Builders and Workmen Act*[21]. This was a short statute which required builders to maintain pay lists for time worked and amounts owing to each of their employees. The employees were granted rights of action to sue for unpaid wages, and if the owner directly paid the wages claimed, its payment obligations to the contractor were accordingly reduced.

The statute continued to be employee-focussed with various minor revisions and name changes from 1883 to 1932. In that year, amendments to *The Builders' and Workmens Act*[22], as it was then re-named, added beneficiaries to serve as the base for introduction in Manitoba of a statutory trust intended to keep construction contract funds within the contract pyramid for each specific project. The new provisions designated the builder, contractor and sub-contractor as trustees of all payments received on account of the contract price, and listed the beneficiaries to be paid prior to any trustee appropriating or converting any part of the trust fund to his own use or to any use not authorized by the trust.[23]

The Winnipeg Free Press reported on April 11, 1932 that the impetus for the amendment arose from a contractors meeting in Vancouver where it was reported that a similar scheme had originated in the state of Michigan and had been adopted in Wisconsin where it had worked well.

[20] Bristow, *supra* note 4 at footnote 58, 1-11, 1-2. See also *Clarkson Co v Ace Lbr.* [1963] SCR 110 reversing [1962] OR 748 (CA) adopting dissenting judgment at 757.
[21] Then *An Act to Secure the Payment of Builders* (1883) 46 & 47 Vict c 21.
[22] *An Act to amend The Builders' and Workmen's Act,* SMB 1932, c 2.
[23] Ibid, s 1.

In Manitoba, the trust provisions were intended to stop out-of-town contractors from securing Winnipeg contracts without paying their debts. One prominent contractor was quoted as saying:

> We have had for several years contractors stepping into Winnipeg and having a real good time on the proceeds of their contracts, buying cars, living in the best places and carrying on 'high'. Then they leave the city and the country, and behind there is a bad record of debts unpaid for materials and to sub-contractors.[24]

On the same date, the Winnipeg Tribune reported the following:

> Members of the Winnipeg Builders' Exchange and representatives of material supply houses today commended the recent amendment to the Builders' and Workmen's Act as one of the greatest benefits of recent years to the western contracting business.[25]

The trust provisions continued in *The Builders and Workmen Act* with little change until that Act was repealed in 1981 upon the amalgamation of its provisions with lien provisions of *The Mechanics Lien Act*[26] to form the current Act.

Trustees Designated by the Act

The Act contemplates more than one trust fund arising according to whose hands hold money intended for use or used to pay the contract price for work, services and materials provided by the contractor and its sub-contractors to improve the value of an owner's land.

The **owner** is trustee of the sums it receives to finance a construction project under section 5(2) of the Act. Further, as sums become payable to the contractor on the basis of certification by a payment certifier, all money in the hands of the owner or at any time received by him/her for payment under the contract constitutes a trust fund pursuant to section 5(1) of the Act.

As payments flow down the payment chain, first to the **contractor** (under section 4(1)) and then to the **sub-contractor(s)** (under section 4(2)) each in turn becomes a trustee of all sums received by each of them on account of the contract price.

Duty and Liability of Trustees

Each trustee is expressly directed in the Act to not appropriate or convert any part of a trust fund for which it has responsibility to itself or for its own use or for any use not authorized by the trust until payment has been made to listed beneficiaries of the trust of amounts 'then owing to them'.[27]

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[24] Winnipeg Free Press, "Trust Fund Bill looked upon as boon to builders" (April 11, 1932).
[25] Winnipeg Tribune, "Builders laud amendments to Workmen's Act" (April 11, 1932).
[26] RSM c 157.
[27] *supra* note 1 at ss 4(3), 4(4) & 5(3).

At common law this obligation is part of the fiduciary *Duty of loyalty* that trustees owe to the beneficiaries of a trust.

Breach of trust by a trustee can result in quasi-criminal charges under section 7 of the Act, and upon summary conviction, a fine may be imposed for up to $50,000 or the wrong-doer can face two years imprisonment. This offence may also apply to every officer or director of a corporation who knowingly assents to or acquiesces in an offence under this section.

The trust provisions in the Act do not provide a complete 'code' of applicable law. Common law and equitable trust principles and associated remedies are also available to beneficiaries who are at liberty to sue a trustee for breach of trust and may obtain a personal judgment against the wrong-doer in the event that misdirected trust funds cannot be traced and recovered in a civil proceeding.[28]

Beneficiaries of the Trust

Manitoba's Act lists the contractor, all sub-contractors, all persons who have supplied materials or provided services for purposes of performing the contract or any sub-contract under the contract, the Workers Compensation Board ("WCB") for assessments related to the project and workers employed to perform the contract or a sub-contract under the contract, as beneficiaries entitled to receive trust funds in the hands of the owner.[29]

As contractor claims for payment are certified and project funds are released down the payment chain, the owner is included in the list of beneficiaries entitled to receive trust funds from the contractor for "any set-off or counterclaim relating to performance of the contract".[30] The contractor or sub-contractor is included as a beneficiary entitled to receive trust funds from a sub-contractor for "any set-off or counterclaim relating to the performance of the sub-contract".[31]

Relationship of Trusts to Liens

Section 9 of the Act provides that the existence of a trust or cause of action asserting the existence of a trust or any breach of trust under the Act is not affected by expiry of the time for filing a lien.

Type of Trust Scheme in the Act

In some Canadian jurisdictions, construction trust provisions follow privity of contract and each payer in the contractual chain becomes a trustee only for those with whom it stands in a direct contract, i.e. has privity.[32] Another type of construction trust scheme is discussed in Canada's

[28] See *Glenko Enterprises Ltd. v. Keller*, 2000 MBCA 7, 150 Man R (2d) 1 [Glenko] at 30.
[29] *supra* note 1 at ss 5(1).
[30] Ibid at s 4(1)(d).
[31] Ibid at s 4(2)(d).
[32] The statutes of Ontario, Nova Scotia, Saskatchewan, and British Columbia establish trust relationships between payers and those it has engaged in direct contract pursuant to *Construction Act*, RSO 2017, c 33, s 7(1)&8(1); *Builders' Lien Act*, RSNS

principal text on construction remedies, called an 'envelope trust' with New Brunswick cited as an example.[33] In this type of trust scheme, all money received on account of any contract or sub-contract price constitutes a trust fund for the benefit of everyone supplying work, services or materials on account of a contract or sub-contract.[34]

Manitoba's trust provisions do not fit neatly into either above description. Privity concepts do appear at the level where payments reach the hands of the contractor[35] and sub-contractor[36], but Manitoba's Act is unlike Ontario's where trust funds in the hands of the owner as trustee are solely for the benefit of and payment to the contractor. Instead, in Manitoba, the owner as trustee is prohibited from appropriating or converting any part of the sums obtained to finance the project and amounts certified for payment of parts of the contract price to or for his own use or to or for any use not authorized by the trust *until* the contractor has been paid "**and** provision for the payment of other beneficiaries of the trust have been made."[37]

3. Construction Contract Pyramid and Payment Chains

Construction contracting has evolved in a unique and complex manner. Typically, an owner contracts with a general contractor (hereinafter referred to as the "contractor") who, in turn, contracts individually with a series of specialized sub-contractors, delegating to each of them performance of a specific component of the work. The contractor also enters into a series of contracts with suppliers to obtain the materials it requires to complete its own force's work. Each specialized sub-contractor typically enters into a further series of individual contracts with sub-sub-contractors and with suppliers of the materials it requires to complete its delegated component of the work, and so on.

The result, even on small construction projects, is formation of a *construction contract pyramid* made up of a multitude of two-party contracts which form a series of *payment chains* that require payment for completed work to flow from owner to contractor to sub-contractor/supplier, and so on down each particular contractual payment chain. There is considerable legal risk in this contractual arrangement for innocent parties whose contracts are remote from the owner and contractor. Legal action in contract is available only against the party with whom each specific payee enjoys *privity* of contract.

The Builders' Liens Act of Manitoba and similar statutes in other provinces and territories have long provided remedial schemes intended to supplement and enhance inadequate contractual

1989, c 277, ss 44A(1) & 44B(1); *The Builders' Lien Act*, SS 1984-85-86, c B-7.1, ss 6(1), 7(1) & 8(1); and *Builders Lien Act*, SBC 1997, c 45, s 10(1).
[33] Bristow, *supra* note 4 at 9-13.
[34] Ibid.
[35] *supra* note 1 at s 4(3).
[36] Ibid at s 4(4).
[37] Ibid at s 5(3).

remedies allowing more effective means to collect payment from various sources or levels within the construction contract pyramid.

4. Need for Reform

Time for Review:

The last major review of Manitoba's construction industry remedial legislation was conducted by the MLRC during the 1970s and took almost 10 years to complete.[38] At that time many other Canadian provinces were also reviewing their lien legislation. The end result in Manitoba was introduction of *The Builders' Liens Act*[39] in 1981 which brought together for the first time in one statute the province's remedial legislative schemes for builders' liens and construction project trust provisions. Miscellaneous ideas for reform were also gleaned at that time from other provinces including the concept of substantial performance, timed release of holdbacks, and enhanced lien vacation procedures.

The 1981 version of the Act immediately generated calls for clarification and correction.[40] Statutory amendments were made four times between 1982 and 1985.[41] Legislative amendments made to the Act since 1987 have not made fundamental changes.[42]

Manitoba has now had more than thirty-five years experience with the legislative reforms initiated in 1981. It is time to review and refresh the Act.

Judicial Criticisms of the Act:

Improvements made in the 1981 Act have been noted. Lien actions for sale of land have become uncommon to non-existent. Improved lien vacation proceedings have come to the forefront, effectively freeing 'the hand of the paymaster' and providing a model for consensual posting of security and discharge of liens where possible.

Slightly expanded statutory trust provisions adopted in 1981 sustained the established standard for commercial morality in the industry by continuing to require payment of amounts due to beneficiaries of the trust on a specific construction project before trust money could be applied to unauthorized purposes. Very few breach of trust proceedings have, however, been commenced under the Act seeking to trace funds lost or to enforce either civil or quasi-criminal consequences

[38] Manitoba Report, 1979 *supra* note 2.
[39] SM 1980-81 c 27.
[40] Manitoba Legislative Assembly, Debates and Proceedings (Hansard), 32nd Leg, 1st Sess, No 80B (21 June 1982) at 3406 (Hon R Penner).
[41] SM 1982, c 47, SM 1982-83-84, c 70, SM 1984-85, c 19, s 1, SM 1985-89, c 51, s 2.
[42] See RSM 1987 Corr; SM 1989-90, s 1; SM 1991-92, c 9, s 250; SM 1991-92, c 41, s 1; SM 1992, c 35, s 58, SM 1992, c 46, s 52, SM 1993, c 4, s 225, SM 1993, c 8, SM 1996, c 79, s 30, SM 2001, c 43, s 34, SM 2002, c 24, s 5; SM 2002, c 48, s 28; SM 2005, c 28, s 82, SM 2008, c 42, s 5; SM 2012, c 40, s 51; SM 2013, c 51, Sch A, s 58.

against payers who default in their duties as trustees. Such cases have potentially harsh consequences.[43]

The courts have sometimes struggled to find clarity of legislative intent in the provisions they were asked to enforce. For example, Kroft JA observed:

> …*The Builders' Liens Act* is not a seamless or symmetric web. It might be better described as a jigsaw puzzle which not only has a few pieces missing but to complicate matters further includes additional pieces from other puzzles.[44]

In 2015, when a novel argument arising under Manitoba's Act in a lien vacation proceeding was heard by the Supreme Court of Canada, Rothstein, J, for the Court observed:

> The trust provisions were formerly provided for in *The Builders and Workers Act*, R.S.M. 1970, c. B90, while the lien provisions were provided for in *The Mechanics' Liens Act,* R.S.M. 1970, c. M80. These two acts were repealed and essentially incorporated into the *BLA*, S.M. 1980-81, c. 7, in 1981 as a result of the 1979 Commission Report (Provincial Drywall, at para. 22). However, in consolidating these two acts, the legislature did not expressly delineate how the lien and trust provisions were to interact in situations such as this case, where both remedies are pursued at the same time by a contractor or subcontractor.[45]

These judicial criticisms need to be addressed to permit more effective administration of justice in Manitoba.

Changes in the Industry:

Manitoba's construction industry has grown and is undergoing significant change. Canadian standard form contracts[46], which include reasonable payment terms, are readily available and much used, but public and private owners continue to develop special form contracts that allow for modern methods of financing, design and construction of their projects. Changed project delivery models such as P3s (public-private partnerships) can substantially alter aspects of the classic construction contract pyramid, introducing long-term licence/lease arrangements on Crown-owned lands with operation and maintenance obligations for the new structure/facility typically remaining in private hands for thirty year terms. Integrated design-build project delivery models[47]

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[43] See, for example, *Emco Ltd. v. Rooftop Roofing Ltd.*, 2002 MBQB 87, 162 Man R (2d) 316; *Provincial Drywall Supply Limited v. Toronto-Dominion Bank*, 2001 MBCA 38, [2001] M.J. No. 112 [*Provincial Drywall*]*; MG Electric Ltd. v. (CSE) Control Systems Engineering Inc.* (2004), 37 CLR (3d) 126 (Man QB), affirmed (2004), 41 CLR (3d) 296 (Man CA)[*MG Electric*].

[44] *Prov. Drywall v. Gateway*, 85 Man R (2d) 116 - 1993 CanLII 9375 (MBCA) at para. 23.

[45] *Stuart Olson Dominion Construction Ltd. v. Structal Heavy Steel*, 2015 SCC 43, [2015] 3 SCR 127, para. 33[*Structal*].

[46] Standard construction contracts typically used in Canada are those developed by the Canadian Construction Documents Committee (CCDC), a national joint committee including owner representatives and appointed members from the Association of Canadian Engineering Companies, Canadian Construction Association, Construction Specifications Canada and Architectural Institute of Canada.

[47] "integrated design-build project delivery model" is a project delivery model where design work and the construction phase proceed coincidentally as opposed to the classic sequence of design, procurement of a contractor and then construction based on a fully completed design.

are increasingly used. Construction management[48] in various forms is also popular. The impact of all of these changes on contract forms, the classic payment chain, payment terms, and inherent risks call for review and possible adjustments within the Act.

Demands for Prompt Payment Legislation:

Terms in standard form Canadian construction contracts set out a process for monthly progress payment claims, payment certification requirements, and require owners to make periodic payments to contractors of the amounts certified[49] for payment before the end of the month following the claim submission date. Payment is normally due to the contractor within less than thirty days from the invoice date.

Subcontract terms typically require a contractor to pay its sub-contractors/suppliers amounts due to each of them within five to seven days of the payer's receipt of payment from higher up the payment chain. "Pay When Paid" clauses are common in Canadian sub-contracts. "Pay If Paid" clauses also appear.

Sub-contractors and suppliers have argued that delay in their payments means that they are, in effect, financing construction projects. In the Ontario Report, an examination of this and related issues cited an analysis by Prompt Payment Ontario[50], based on Statistics Canada national data.[51] According to this analysis, the average age of accounts receivable in the construction industry in Ontario was reported to have increased from 57.3 days in 2002 to 71.1 days in 2013 while, in contrast, a stable 47 day average collection period was found in other industries.[52]

Manitoba Senator Donald Plett introduced Bill S-224, *An Act to require prompt payment on Federal construction projects*[53] on April 13, 2016. The Bill received third and final reading in the Senate on May 4, 2017 and it has been sent to the House of Commons for further consideration and possible enactment.

Manitoba sub-contractors have been seeking legislative intervention since at least 2009 to address their prompt payment problems/requirements in this province. It is reported that similar payment problems and demands for a solution are in process across Canada.

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[48] "Construction management" refers to a project delivery model in which an owner typically retains a general contractor to assist in procurement and management of trade contractors.

[49] Section 1(1) of *The Builders' Liens Act* states that the "payment certifier" is "…an architect, engineer or other person upon whose certificate payments are made under a contract".

[50] According to its website, http://ontariopromptpayment.com/#about, Prompt Payment Ontario is "a sole-purpose alliance or coalition of contractor associations, unions, suppliers, general contractors, pension trust funds, and anyone else who has an interest is seeing prompt payment legislation enacted in the province of Ontario. Its purpose and goal are just that, to persuade the Ontario government that delinquent payment is a growing problem in the construction industry and that legislation is needed to ensure that money flows as it is intended down through the contractor supply chain."

[51] Ontario Report, supra note 3 at 178-179.

[52] Ibid.

[53] Bill S-224, *An Act to require prompt payment on Federal construction projects,* 1st Sess, 42nd Parl, 2017, (third reading in Senate 4 May 2017).

Ontario's Prompt Payment Legislative Experience:

For several years, construction industry representatives in Ontario have pursued enactment of stand-alone prompt payment legislation in that province. Bill 69, *An Act respecting payments made under contracts and subcontracts in the construction industry*[54] was introduced in the Ontario Provincial Parliament on May 13, 2013. Considerable pressure mounted for and against the Bill, which resolved at legislative hearings in 2014 when passage of Bill 69 was denied. The Ontario Attorney General and Minister of Economic Development, Employment and Infrastructure thereafter commissioned experienced construction lawyers to examine the issue and provide expert advice on prompt payment legislative options, including possible amendment to Ontario's *Construction Lien Act*[55]. On April 30, 2016, the Ontario government released the resulting Ontario Report, which included a comprehensive assessment of prompt payment regimes world-wide and recommended significant amendments to Ontario's Act.

On December 5, 2017, the Ontario Parliament passed Bill 142- *Construction Lien Amendment Act*[56] adopting many of the recommendations contained in the Ontario Report. The Act was re-titled the *Construction Act*[57] and arguably the most significant change was the introduction of a prompt payment regime within that time-honoured industry-specific remedial legislative context. Prompt payment legislation is a current topic important to Manitoba's construction industry and is therefore an appropriate issue for consideration in this paper.

5. Objectives and Structure of the Review

Pursuant to its governing legislation, the MLRC's mandate is to improve, modernize and reform the law and improve the administration of justice in Manitoba.[58]

Regular review and updating of particular statutes is one means of performing this function. Addressing problems within an existing Act, especially when identified by the judiciary, is another. Keeping pace with societal changes affecting user groups reliant upon particular statutes and giving due consideration to industry demands for more legislative intervention, as in the present circumstances, are still further means of performing the MLRC's function.

Accordingly, questions for consultation and feedback have been developed on the basis of the current structure and contents of the Act with attention to judicial criticisms and industry calls for additional legislative relief respecting prompt payment.

[54] 2nd Sess, 40th Leg, Ontario, 2013.
[55] RSO 1990 c C.30 [*Construction Lien Act*].
[56] 2 Sess, 41st Parl, Ontario, 2017 (assented to 5 December 2017)[*Construction Lien Amendment Act*].
[57] RSO 2017, c 33 [*Construction Act]*.
[58] *The Manitoba Law Reform Commission Act,* CCSM c L95 at s 6.

This review will be guided by the long-standing purpose of the Act as expressed in the 1979 MLRC Report and recently cited with approval by Manitoba's Court of Appeal:

> […] The fundamental purpose of this legislation [*The Mechanics Liens Act*] and *"The Builders and Workers Act*, (C.C.S.M. cap. B90) is to ensure that a person contributing to the improvement of land is paid for that contribution in accordance with his contractual entitlement.[59] [emphasis in original]

Five main review and reform topics have been identified for consideration in this Consultation Paper, namely:

1. **Enhancement of Existing Trust Provisions**
   A brief discussion of basic trust law principles will be provided to guide Stakeholder consideration of options for enhancing the 'bare bone' trust provisions in the current Act.

2. **Update General Application & Lien Provisions**
   The paper will discuss the lien provisions and sections of the Act of general application and options will be proposed for clarifying and updating certain lien provisions in the Act.

3. **Interaction of Trust and Lien Provisions**
   The Supreme Court of Canada's decision in *Stuart Olson v Structal* will be discussed together with the issue of how to better address the interaction between trust and lien provisions.

4. **Update Dispute Resolution Procedures in the Act**
   Issues in the enforcement of trust and lien remedies under the Act will be discussed and possible options for updating current court procedures will be put forward for discussion.

5. **Prompt Payment Regime**
   Consideration will be given to whether Manitoba's Act ought to be amended to incorporate typical components of a prompt payment regime, whether the trust provisions in the Act may be used as the foundation of such a regime, and what other potential options ought to be considered to ensure the timely flow of periodic payments from the apex of the *construction contract pyramid* down to the sub-contractors and suppliers at its base.

Consultation Process

A total of 46 Issues for Discussion are posed as either open-ended or specific questions within this Consultation Paper. The Commission will consider Stakeholder responses in formulating its

[59] *Canotech Consultants Ltd. v. 5994731 Manitoba Ltd.*, 2017 MBCA 48 at para 21.

recommendations. If you have comments about other relevant matters, please include them in your submission.

Written comments on the Consultation Paper may be submitted until April 2, 2018 as set out in the Invitation to Comment at page iii of this Consultation Paper. The opportunity will also be provided in April – May 2018 for any Stakeholder wishing to make a brief oral presentation and discuss issues arising from the Consultation Paper with Commission personnel.

CHAPTER 2 – TRUST LAW PRINCIPLES AND PROVISIONS OF THE ACT

1. Origin of Trust Law and Manitoba's Legislation

The necessity arose in England during the Crusades in the Middle Ages to devise a method for regulating the conduct of persons who held property for the use or benefit of others. Equity courts administered by the church devised the concept of a 'trust' which was eventually accepted into English common law and continues to this day.

Prior to introduction of the Act in 1981, *The Builders and Workers Act*[60] of Manitoba set out the Legislature's intention to create a statutory trust for construction industry participants. Payments received by contractors and subcontractors on account of a construction contract price constituted the trust funds.[61] Beneficiaries entitled to be paid from the trust funds expressly included:

> ...the proprietor, builder or contractor, sub-contractors, Workers Compensation Board, workmen, and persons who have supplied material on account of the contract.[62]

The contractor and sub-contractor as payees were designated trustees of contract amounts received by each of them.[63] Express terms of the trust required that, until all beneficiaries were paid for work, services or materials supplied, the trustees were not to appropriate or convert any part of the trust fund to their own or any other unauthorized use.[64]

No mention was made in *The Builders and Workers Act* of a civil right of action for breach of trust, however, silence on this issue left available the common law right of a beneficiary to sue seeking to trace trust property lost and/or to sue seeking personal judgment against the wrongdoer in the event of misappropriation or conversion of trust funds.

The section setting out the trust provisions in *The Builders and Workers Act* was followed by a caution that stated:

> NOTE: Penalty for Criminal Breach of Trust – See sec. 282 of the Criminal Code

As a result of the 1979 MLRC Report, *The Builders and Workers Act* was repealed. Statutory trust provisions for the construction industry were carried forward and expanded in the Act.

[60] RSM, c B90.
[61] Ibid, s 3(1).
[62] Ibid.
[63] Ibid s 3(2).
[64] Ibid.

2. Three Requirements for a Valid Trust

To be valid and enforceable, an express trust must be created in accordance with 'the three certainties', namely:

1. Certainty of intention (to create a trust);
2. Certainty of subject matter (property in the trust); and
3. Certainty of object(s) (purpose and/or beneficiaries of the trust).

Consideration is given below to the manner in which the Act seeks to satisfy the three certainties.

a. Certainty of Intention

Federal and provincial governments have found trusts to be useful legal constructs for regulating the conduct of persons who must collect and remit source deductions, GST, provincial sales tax, etc. for the use and benefit of government. In such cases, legislation is passed to impose trust obligations and Canadian courts have generally accepted without much analysis that such statutes satisfy the requirement for 'certainty of intention' to create a valid and enforceable statutory trust.[65]

b. Certainty of Subject Matter

The second certainty required to create a valid and enforceable express trust calls for clear identification of the property which is subject to the trust. Where the trust property is a physical object or piece of land, certainty as to subject matter is easy to achieve. Where, however, a mere sum of money is the subject matter of the trust, certainty of its identification can easily be lost through use or simply by co-mingling the sum with other funds.

The property subject to the trust fund is expressly set out in the Act as:

- "all funds received by an owner that are to be used in the financing of a structure or improving land [less the purchase price and cost of removing prior encumbrances] […] constitute a trust fund [...]"[66];
- "…sums [that] become payable to a contractor by the owner on the basis of a certificate of a payment certifier … in the hands of the owner" at the time certified or at any time thereafter constitute, until paid, a trust fund[67];
- "all sums […] received by a contractor on account of a contract price constitute a trust fund […]"[68]; and
- "all sums […] received by a sub-contractor on account of a contract price in the sub-contract, constitute a trust fund […]."[69]

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[65] *British Columbia v. Henfrey*, [1989] 2 SCR 24, 59 DLR (4th) 726.
[66] *supra* note 1, s 5(2).
[67] Ibid, s 5(1).
[68] Ibid, s 4(1).
[69] Ibid, s 4(2).

c. Certainty of Object(s)

The creator of a valid and enforceable express trust must make clear at the time of creation of the trust the purpose for which the trust property may be used (such as in a charitable trust) or the class of specific persons or 'beneficiaries' who shall be entitled to receive the trust property.

The Act provides that both at the time an owner receives money to finance a construction project under section 5(2) and at the time that a portion of the contract price is certified for payment under section 5(1), the objects or beneficiaries of trust funds in the owner's hands are:

(a) the contractor and all sub-contractors and other persons who have supplied materials or provided services for the purpose of performing the contract or any sub-contract under the contract;
(b) the WCB; and
(c) workers who have been employed for the purpose of performing the contract or sub-contract under the contract.[70]

As portions of the contract price flow down the payment chain, the list of identifiable beneficiaries expands. Under section 4(1), beneficiaries entitled to payment from trust funds received by the contractor are those with whom the contractor has a direct contract and enjoys *privity*, or, in the case of the WCB, has a direct payment obligation, namely:

(a) sub-contractors, suppliers and others who have contracted with the contractor....;
(b) the WCB (for the contractor's assessments respecting its work);
(c) workers who have been employed by the contractor.....; and
(d) the owner for any set-off or counterclaim relating to the performance of the contract.

Under section 4(2) of the Act, beneficiaries entitled to payment from trust funds received by a sub-contractor are also those with whom the sub-contractor has a direct contract/enjoys *privity*, or to whom the sub-contractor has a direct payment obligation as follows:

(a) sub-contractors, suppliers and others who have sub-contract with the sub-contractor....;
(b) the WCB for the sub-contactor's assessments respecting its work;
(c) workers who have been employed by the sub-contractor.....; and
(d) the contractor or any sub-contractor for any set-off or counterclaim relating to the performance of the sub-contract.

Persons named as beneficiaries of trust funds created at each specific level in the construction contract pyramid appear to satisfy the requirement for certainty. The objects (beneficiaries) of a trust should be selected to meet the 'objective' or purpose of the trust. In Chapter 3 of this Paper,

[70] Ibid, s 5(1) & 5(2).

Stakeholders will be invited to consider whether the existing list of beneficiaries in the Act conforms to this principle.

3. Breach of Trust: Civil and Criminal Liability

Loss or damage to beneficiaries caused by a failure of a trustee to properly discharge its duties gives rise to a civil cause of action for breach of trust. A beneficiary suing in the civil courts for breach of trust has two possible avenues to pursue, namely:

1. An action *in rem* for recovery of the trust property; and/or
2. An action *in personam* against the defaulting trustee personally seeking a money judgment to compensate for damages suffered.

An action *in rem* typically requires immediate efforts to follow and find (trace) misappropriated or converted trust property. Where the property in the trust is money, the identity of the subject matter of the trust is easily lost. If the trustee deposits trust money into a general bank account, co-mingling it with other trust funds and his own funds after which the trustee draws funds from that general account for any purpose, the probability of successfully tracing and recovering a sum equal to the trust money deposited can be seriously compromised or lost. Section 8 expressly limits the time to commence an action *in rem* for recovery of trust monies to 180 days from the date on which the claimant became aware of the breach.

A civil action *in personam* seeking personal judgment for damages resulting from a trustee's breach of trust under the Act is not mentioned in the statute but is, never-the-less, available to beneficiaries. The normal limitation period prescribed in *The Limitations of Actions Act*[71] to commence an action for breach of trust is six years from becoming aware of the breach.[72]

With the introduction of the Act, the Legislature added section 7 which makes a breach of trust described in that section a summary conviction offence with potential penalties of $50,000 payable to the Crown, and a term of incarceration for up to two years. Truly egregious misappropriation or conversion of trust property by a trustee or knowing third party may result in criminal charges and there is at least one reported decision of charges tried under this section of the Act.[73] Although there is no longer any express 'Note' or other reference in the Act, section 336 of the Canadian Criminal Code continues to provide for conviction and punishment for breach of trust with more severe penalties than those for summary conviction under the Act.

There is Canadian case law which finds that a trustee who grants a security interest to his bank in his accounts receivable so that the bank is able to register a secured charge against such accounts also constitutes an actionable breach of trust.[74]

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[71] CCSM c L150.
[72] Ibid, s 49(3). Commentary can be found in *Glenko Enterprises Ltd. v. Keller*, 2000 MBCA 7, [2000] M.J. No. 444 at para. 42.
[73] *R. v. Sopko*, [1991] M.J. No. 245, 74 Man R (2d) 34.
[74] *Air Canada v M & R Travel Ltd.*, [1993] 3 SCR, 826, 1993 CanLII 33 (SCC) [*Air Canada*]; *Glenko, supra* note 28.

4. Terms of the Trust

General trust law principles direct that the settlor/creator of the trust may impose specific terms for administration of an express trust. Common law duties, rules for property disposition and discretion in the trustee may be expanded or reduced to better serve the objects of the trust. Priorities among beneficiaries may be prescribed. Beyond the requirement that the creator of a trust must satisfy the three certainties to form a valid and enforceable express trust, terms for administration of the trust can take many different paths.

Based on the Act's intended purpose, a statutory trust created under *The Builders' Liens Act* should serve the legislative purpose of guiding project funds into the hands of those who participate in improving the value of an owner's land.

a. Appointment of Trustees:

The Legislature has provided that the owner, then the contractor and finally those sub-contractors who receive payments, which include sums due to parties below them in the payment chain, are each designated as 'trustees'.[75]

b. Equitable Duties of the Trustees:

The person or persons appointed by the creator of a trust to hold trust property for the benefit of others are called 'trustee(s)'. Trustees who accept the appointment are obliged at common law to conduct themselves as fiduciaries in the administration of a trust in accordance with the following duties:

- duty to strictly obey the trust instrument;
- duty of impartiality/neutrality among beneficiaries;
- duty to act in the best interests of the beneficiaries;
- duty of *good faith* which requires exercise of any discretionary power permitted to the trustee by the trust instrument with honesty, integrity, objectivity, care and impartiality, with the obligation to inform himself of all relevant considerations before making a decision;
- duty of care when managing the trust property, with the obligation to repair the trust property and see that its condition does not deteriorate;
- duty of loyalty to beneficiaries and to not place himself in a position where his personal interests conflict with his fiduciary duties; and
- duty to account providing full and accurate information as to the amount and state of the trust property.[76]

[75] *supra* note 1, ss 4(3), 4(4), 5(1), & 5(2).
[76] Michelle I. Issak, "What it Means to Be a Trustee: A Guide for Clients Acting as Fiduciaries" (October 2012) online: The Continuing Legal Education Society of British Columbia <https://www.cle.bc.ca/PracticePoints/WILL/12Trusteesectionpdf cle.bc.ca.>.

Trust law does permit trustees to also be beneficiaries of a trust, however, equity requires that no unfair advantage is to be taken by a trustee. In such circumstances, the trustee should seek to act as if he was an independent trustee with no interest in the outcome.[77]

At the apex of the construction contract pyramid, the owner as trustee of all sums received for use in financing the project and then as trustee of specific sums certified for payment to the contractor, is prohibited by section 5(3) of the Act from appropriating or converting any part of the trust fund to or for his own use or to or for any use not authorized by the trust *until*:

1. the contractor has been paid all sums justly owed to him in respect of the performance of the contract; and
2. provision has been made for the payment of other affected beneficiaries of the trust.

The contractor is likewise expressly prohibited in section 4(3) of the Act from appropriating or converting any part of the trust fund to or for his own use or to or for any use not authorized by the trust *until*:

1. all of its direct sub-contractors and suppliers *have been paid all amounts then owing to them out of the sum received;*
2. WCB has been paid all assessments the contractor could reasonably anticipate as arising out of the work done by its own workers *to the extent for which the sum was received;*
3. All workers who have been employed by him for purposes of performing the contract *have been paid the amounts then owing to them out of the sum received* for work done in performing the contract; and
4. Provision has been made for the payment of other affected beneficiaries of the trust to whom *amounts are then owing out of the sum received.*

Trustee sub-contractors have duties prescribed in section 4(4), which are the same as those of the contractor listed above, modified only to deal with their own direct payment obligations.

Express terms of the trust direct with considerable precision that each amount certified on account of the contract price for payment at the apex of the construction contract pyramid passed down the payment chain shall be paid to the specific beneficiaries whose completed work was assessed, included in each progress claim and certified for payment.

5. Exceptions to Section 4(3), 5(2) and (5(3)

a. Direct Payments by Owner

Section 5(4) of the Act expressly, but conditionally, authorizes the owner to retain a sum equal to the amount it has directly paid to a beneficiary of the trust, which retention will not be deemed to

[77] Ibid at p 2.1.4.

be an appropriation or conversion to his own use if, prior to the retention, all beneficiaries of the trust entitled under him have been paid in full. The utility of this provision will be considered further in Chapter 3: Options for Enhancement of Current Trust Provisions.

b. Loan Repayments from Trust Funds

Under the curious heading of 'Protection of money lenders', section 6(1) of the Act provides that a trustee who has borrowed money and used it to pay a beneficiary of the trust may then use trust money to discharge the loan and that such a 'use' will not be deemed an appropriation or conversion to his own use or for a use not authorized by the trust. Note that the section has nothing to do with lenders who provide funds to a trustee and, therefore, there is no apparent need for reference to 'protection' in that regard. The heading needs to be amended.

Additionally, no statutory guidance is provided in section 6(1) or elsewhere in the Act, as would seem appropriate, to ensure that only the beneficiary(ies) paid with the borrowed funds bear the consequences of the authorized claw-back by the trustee.

The above criticisms of existing provisions will be discussed again in Chapter 3: Options for Enhancement of Current Trust Provisions.

c. Assignment of Trust Funds Permitted

Sub-sections 6(3) and 6(4) of the Act expressly contemplate and therefore implicitly condone assignment of trust monies by trustees:

> **Assignment not valid against lien or trust**
> 6(3) No assignment by the contractor or sub-contractor of any moneys due or to become due on account of the contract price under a contract or sub-contract is valid as against any lien or trust created under this Act.
>
> **Assignment subject to trust**
> 6(4) Where a right to payment of moneys, which upon receipt by the assignor would be subject to a trust under this Act, is assigned, or purported to be assigned, moneys received by the assignee under the assignment or purported assignment are subject to the trust and the assignee is the trustee.

The issues that arise upon the assignment of trust funds are discussed in detail in Chapter 3.

CHAPTER 3- OPTIONS FOR ENHANCEMENT OF CURRENT TRUST PROVISIONS

Existing trust provisions in the Act are generally silent about the common law and equitable principles which apply to their use. In some cases, the Act expressly overrides fundamental trust law principles. This MLRC review provides an ideal opportunity to revisit the basic express trust provisions in the Act. Areas for discussion are set out in this Chapter for Stakeholder consideration and comment under the five general headings below, namely:

1. The Three Certainties,
2. Beneficiaries of the Trust;
3. Terms for Administration of the Trust,
4. Liability for Breach of Trust,
5. Extending Rights to Trust Beneficiaries.

1. The Three Certainties:

To survive a legal challenge, trusts imposed by the Act must be able to satisfy the three certainties discussed in Chapter 2 of this Paper. Challenges could come from within the construction contract pyramid from a trustee facing allegations of breach of trust. Challenges to statutory trusts also arise upon the insolvency of a participant in a construction project where the protective schemes in the Act are exposed to competing claims from other creditors, and sometimes from the Federal and Provincial governments under other legislative schemes.

a) Certainty of Intent to Create a Trust

The Legislature's intention to continue its long tradition in the Act of providing a statutory remedial trust for the benefit of persons in the construction industry is clear.

b) Certainty of Subject Matter (Property) of the Trust

As set out in Chapter 2, the series of trust funds created in sections 4 and 5 of the Act are rather jumbled. These provisions were pieced together in 1981 from more than one source without regard to the normal sequence of events on a construction project which bring such funds into existence. For the sake of clarity, an option for reform could be to have the Act sequentially state that:

- all sums received by the owner for use in financing a construction project constitute a trust fund for the stated purpose of the trust;
- all sums certified for payment from the trust fund on account of the contract price and paid by the owner to the contractor are received in trust for use in accordance with the terms of the trust; and

- all sums certified for payment from the trust fund to the contractor that were earned by a sub-contractor and are paid to a sub-contractor by the contractor are received in trust for use in accordance with the terms of the trust.

ISSUE FOR DISCUSSION #1

Would modifications and re-ordering of current sections 4(1), 4(2), 5(1) and 5(2) of the Act help clarify the legislative intent to create a single trust fund in the owner's hands, the terms of which follow each amount certified and released from that fund as it flows down the payment chain?

c) Certainty of Object(s) of the Trust

i. Basic Object or Purpose of the Trust

If the Act is amended to include an express statement of the purpose or object of the trust, it might state:

> *The purpose of trust provisions in this Act is to regulate the flow of payments made on account of the contract price to ensure that the contractor, sub-contractors and suppliers who have provided work, services and materials in accordance with terms of the contract are duly paid for their completed work in preference to all others not named as beneficiaries of the trust.*

ISSUE FOR DISCUSSION #2

Does the above statement reflect your understanding of the basic purpose of the trust provisions in the Act?

2. Beneficiaries of the Trust

a) Priority Amongst Beneficiaries

Lists of beneficiaries are set out in sections 4 and 5 of the Act for each level of contracts and sub-contracts as trust funds flow down the payment chain:

> **Receipts of contractor constitute trust fund**
> **4(1)** All sums, including any interest on the holdback, received by a contractor on account of a contract price constitute a trust fund for the benefit of

(a) sub-contractors who have sub-contracted with the contractor and other persons who have supplied materials or provided services to the contractor for the purpose of performing the contract;
(b) the Workers' Compensation Board;
(c) workers who have been employed by the contractor for the purpose of performing the contract; and
(d) the owner for any set-off or counterclaim relating to the performance of the contract.

Receipts of sub-contractor constitute trust fund
4(2) All sums, including any interest on the holdback, received by a sub-contractor on account of a contract price in the sub-contract, constitute a trust fund for the benefit of
(a) sub-contractors who have sub-contract with the sub-contractor and other persons who have supplied materials or provided services to the sub-contractor for the purpose of performing the sub-contract;
(b) the Workers' Compensation Board;
(c) workers who have been employed by the sub-contractor for the purpose of performing the sub-contract; and
(d) the contractor or any sub-contractor for any set-off or counterclaim relating to the performance of the sub-contract.
...
Receipts and moneys of owner constitute trust fund
5(1) Where, under a contract, sums become payable to the contractor by the owner on the basis of a certificate of a payment certifier, any amount, up to the aggregate of the sums so certified, that is in the hands of the owner or received by him at any time thereafter for payment under the contract constitutes, until paid to the contractor, a trust fund for the benefit of
(a) the contractor and all sub-contractors and other persons who have supplied materials or provided services for the purposes of performing the contract or any sub-contract under the contract;
(b) The Workers Compensation Board; and
(c) workers who have been employed for the purpose of performing the contract or any sub-contract under the contract.

In its current state, the Act does not expressly assign priority or rank the listed beneficiaries. Consideration could be given to prioritization or ranking of the listed beneficiaries.

The argument could be made that each beneficiary or class of beneficiaries was meant to be ranked or prioritized on the basis of where they appear on the list. This would put the contractor followed by each level of sub-contractors and/or suppliers at the top of each respective list to the extent of 'the amount then owing to each of them out of the sum received'. This may be an appropriate result, given the long-stated purpose of the trust. Trust principles summarized in Chapter 2 of this Consultation Paper also support an interpretation which would restrict to the very end of each list any claims for set off and counterclaim for the benefit of persons who are also trustees.

This reform could be achieved by amending subsections 4(3) and 4(4) by merely adding to the end of each subsection the following words:

> *....with all payments to be distributed in priority according to the order in which beneficiaries are listed above.*

ISSUE FOR DISCUSSION #3

Should beneficiaries' claims be prioritized in the order currently set out in sections 4 and 5 of the Act? If not, should proper claims be prioritized in another manner?

b) Possible Amendments to the List of Beneficiaries of the Trust

i. Workers' Compensation Board (WCB)

The Act not only gives beneficiary status to those persons who have contracted to improve the value of an owner's land, but also confers beneficiary status directly on the provincial government agency that provides compensation to injured workers. The WCB was originally added as a beneficiary when Manitoba's remedial trust provisions were originally added to *The Builders' and Workers Act* in 1932. The no-fault worker compensation system administered by the WCB was introduced in Manitoba twelve years earlier in 1920.[78]

The obligation of contractors and sub-contractors to pay assessments to the WCB to fund the no-fault worker compensation system in Manitoba represents an overhead or business operating cost not unlike the obligation to remit payroll tax, source deductions, goods and sales tax, etc. In the event of default, the WCB statute provides various avenues of recourse, including certain rights to recover against an owner on whose land compensable injuries might occur.[79] In this sense, there is a link between a specific work site, the number and type of workers employed there in a given pay period and the amount of WCB dues assessed from time to time against their employers.

WCB assessments are not, however, a specific line item in the schedule of values around which payment certification is typically organized in standard form construction contracts. Instead, the Act calls for the payer's 'reasonable anticipation' of its WCB assessment amount that relates to its own forces work for which payment has been certified and paid.

Standard form Canadian construction contracts have evolved since 1932 to expressly impose positive obligations on contractors to provide certificates of compliance to owners as evidence that their WCB assessment obligations have been satisfied. This procedure appropriately obliges the

[78] *The Workmens' Compensation Act,* RSM 1920, c 159.
[79] *The Workers Compensation Act*, CCSM c W200, ss 85(1) & (2).

contractor to attend to this overhead cost in the ordinary course without need for any 'belts and suspenders' giving special status to the WCB against the trust funds created in the Act.

The only other province with legislation including the equivalent organization responsible for the compensation of workers as a beneficiary to trust funds in the construction industry is New Brunswick.[80] Although construction lien acts in British Columbia, Ontario and Saskatchewan at one time also expressly included workers compensation boards in their lists of beneficiaries under their statutory trust provisions, they no longer do.[81]

ISSUE FOR DISCUSSION #4

Do you believe that the WCB should remain a beneficiary of trust monies under the Act or, in your view, should it be removed from sections 4 and 5?

ii. Wage Earners

The inclusion of workers employed by a contractor or sub-contractor who perform work under the contract or sub-contract as trust fund beneficiaries also calls for review.

Historically, salaried construction company employees in Manitoba were extremely vulnerable in the event of payment disruptions affecting their employers. In 1883, this was, in fact, the target group for statutory relief under *The Builders' and Workmen Act.* Since then, however, a comprehensive scheme of Manitoba labour laws has developed to fully occupy the field,[82] which provides much more timely and effective recourse than can arise under the Act where provisions focus on recovery of monthly construction contract progress payments, at best. Salaried employees are typically entitled to bi-monthly payment, so that disruption in their pay requires more immediate attention and relief.

In the MLRC's 1979 Report, observations were made that workers at that time rarely if ever sought recourse under *The Builders' and Workers Act.*[83] After some consideration, the Commissioners declined to recommend removal of workers from the beneficiary lists in the Act out of an abundance of caution.[84] Now, more than thirty-five years later, workers are virtually never seen to seek relief under the Act.

[80] *Mechanics' Lien Act*, RSNB 1973, c M-6, s 3(1).
[81] Bristow, *supra* note 4, 9-18, para 9.3.1.
[82] See *The Employment Standards Code*, CCSM c E110.
[83] Manitoba Report, 1979 *supra* note 2 at p 27.
[84] Ibid.

Each of the provinces which have trust provisions, being British Columbia, Alberta, Saskatchewan, Ontario, New Brunswick, and Nova Scotia, enable wage earners or labourers to be beneficiaries of trust funds of a contractor or sub-contractor.[85]

ISSUE FOR DISCUSSION #5

Do you believe that wage earners should remain beneficiaries to trust monies under the Act or should they be removed from the list of beneficiaries?

iii. Trustee Rights of Set-off and Counterclaim

Legal rights of set-off and counterclaim are often agreed to within terms of contracts and are supported or extended by various statutes (i.e. *The Court of Queen's Bench Act, The Law of Property Act,* etc.) and the common law.

When the Act was enacted in 1981, trustees (the owner, the contractor and any sub-contractor) were for the first time expressly permitted by Manitoba's legislature to recover set-offs and counterclaims related to performance of the work from trust funds *as beneficiaries* of the trusts created by the Act. These claw-back rights are listed in sub-sections 4(1)(d) and 4(2)(d) of the Act:

> **Receipts of contractor constitute trust fund**
> 4(1) All sums, including any interest on the holdback, received by a contractor on account of a contract price constitute a trust fund for the benefit of
> […]
> (d) the owner for any set-off or counterclaim relating to the performance of the contract.
>
> **Receipts of sub-contractor constitute trust fund**
> 4(2) All sums, including any interest on the holdback, received by a sub-contractor on account of a contract price in the sub-contract, constitute a trust fund for the benefit of
> […]
> (d) the contractor or any sub-contractor for any set-off or counterclaim relating to the performance of the sub-contract.

We do not know the Legislature's reason for allowing unproven trustee claims for set-offs and counterclaims to rank directly as "beneficial" interests against trust funds. In its 1979 Report, the

[85] *Builders' Lien Act,* RSA 2000, c B-7, s 22(1) [Alberta Act]; *Builders Lien Act*, SBC 1997, c 45 [BC Act], s 10(1); Ontario Act *supra* note 54 at s 8(1)(b); *Builders' Lien Act,* RSNS 1989, c 277 [Nova Scotia Act], s 41B(1)(b); *Builders' Lien Act,* SS 1984-85-86, c B-7.1, s 7(1)(d); *Mechanics' Lien Act,* RSNB 1973, c M-6 [New Brunswick Act], s 3(1).

MLRC, in fact, recommended against extending the obligation of the trust to compensate the owner, contractor, or sub-contractor for set-offs or counterclaims, stating:

> There is no such express statutory right under the present *"Builders and Workers Act".* And, in any event, although it does appear there may be a right to set off or claim in circumstances when it can be argued that the money did not become payable, we have reservations as to whether or not this would, in fact, be an improvement and wonder whether it might cause more harm than good in light of the fact that such obligations are usually spelled out in more detail in the contracts between parties. Whether there is a "just" set-off or counterclaim might also, we think, introduce a criterion other than a contractual one in a dispute which goes to court thereby encouraging needless litigation.[86]

Prior notice of a trustee's intent to exercise recovery rights against trust funds is not required by the Act. There is no express or implied right in the Act permitting affected beneficiaries to call for justification or proof of entitlement nor any power to oppose such deductions before they occur.

It is unclear whether the Legislature intended that trustee set-offs and counterclaims be ranked last with the least potent claim against certified trust funds in pay. If considered as a factor in the 'balance of power' existing today within the payment chain, trustee-payers of trust funds have been given a remarkable advantage over other beneficiaries by enactment of sections 4(1)(d) and section 4(2)(d) in the Act.

In Ontario, while set-offs are not currently restricted to the contracted work, under the amendments recently passed and to be proclaimed in the near future, trustee rights of set-off are now restricted to the applicable improvement except in the event of a contractor's or sub-contractor's insolvency where set-offs may include all outstanding debts, claims or damages, whether or not related to the improvement.[87] The statutes of both Nova Scotia[88] and Saskatchewan[89] allow set-off by trustees. The liens legislation of other provinces with trust provisions do not include express rights to set-off and counterclaim against trust funds by trustees.

ISSUE FOR DISCUSSION #6

(a) Should subsection 4(1)(d) and section 4(2)(d) be removed from the Act terminating 'beneficiary' status for trustees respecting any project related set-offs and counterclaims they may wish to simply deduct from trust funds that have been duly certified and paid?

(b) How do you view the procedures outlined for treatment of set-offs and counterclaims by trustees in Chapter 7- Prompt Payment at page 87 of this Consultation Paper?

[86] Manitoba Report, *supra* note 2 at 45-46.
[87] *Construction Act*, supra note 57, s 12.
[88] Nova Scotia Act *supra* note 85 at s 44(E)(1).
[89] Saskatchewan Act *supra* note 85 at s 13.

iv. Owner as Beneficiary

Subject to final resolution of the issue respecting the statutory facilitation of trustee rights of set-off and counterclaim against trust funds discussed above, there is no apparent reason for an owner/trustee to be named as a beneficiary of the trust.

The owner is trustee of the fund for financing the construction project. The owner has the power to alter the scope of the work, amend the contract price, etc. None of these discretionary powers require the owner to also be a beneficiary of the trust. At most, the Act might expressly provide that upon completion of the project and finalizing all accounts, any surplus remaining in the project trust fund shall revert to the owner.

ISSUE FOR DISCUSSION #7

Should the Act be amended to remove the owner from the list of beneficiaries of the trust or should the owner remain a listed beneficiary?

3. Terms for Administration of the Trust

a) Duties of Trustees

Currently, express duties for trustees are set out in sections 4(3), 4(4) and 5(3) of the Act:

- ***Duty to strictly obey terms of the trust*** by paying amounts earned, claimed, certified and released into the payment chain to each specific beneficiary entitled to be paid from the amount released; and
- ***Duty of loyalty to beneficiaries*** which is expressed as a prohibition against any trustee appropriating trust money to its own use or any other unauthorized use before all beneficiaries have been paid amounts then owing to them.

Consideration should be given to also expressly stating in the Act that all trustees have the *Duty to account* for their handling of trust funds. The common law *Duty to account* requires trustees to provide full and accurate information to beneficiaries as to the amount and state of trust property. Transparency is essential to the proper administration of trusts. Full disclosure of the bases and result for each progress claim and payment certification process would newly empower beneficiaries to pursue and protect their rights on a timely basis.

The owner as trustee has both the power and associated duty to administer the entire project trust fund to achieve the Act's intended purpose. The owner must exercise discretion in its role as trustee and must oversee assessment of the value of work performed, the payment certification/approval process, respond appropriately to claims/disputes arising in the payment

chain and ensure that the project trust fund is sufficient to pay the agreed contract price. These additional powers and functions are required at common law to be exercised in accordance with the Duty *of good faith.*

ISSUE FOR DISCUSSION #8

Should the common law *Duty to account* be expressly required for all trustees under the Act and, further, should the owner as trustee and its delegated payment certifier be expressly required to exercise the additional *Duty of good faith* when administering the project trust fund?

c) Direct Payments by Owner

Section 5(2) of the Act designates sums received by an owner for use in financing a construction project as the initial 'trust fund' on each project:

> **Advances on mortgages, etc.**
> 5(2) All sums received by an owner that are to be used in the financing of a structure or improving land, including the purchase price of the land and payment for the discharge or withdrawal of prior encumbrances against the land, constitute, subject to the payment of the purchase price and of payments for the discharge or withdrawal of prior encumbrances against the land, a trust fund for the benefit of the persons mentioned in subsection (1).

Section 5(4) of the Act treats recovery by an owner from the trust fund of amounts it directly pays to a trust beneficiary as an exception to the *Duty of loyalty* to not pay itself in priority to beneficiaries of the trust:

> **Exception**
> 5(4) Notwithstanding subsection (3), where an owner has himself paid, in whole or in part,
> (a) any sub-contractor or other person who has supplied materials or provided services for the purpose of performing the contract or any sub-contract thereunder;
> (b) any assessment of The Workers Compensation Board arising out of work done in performing the contract or any sub-contract thereunder;
> (c) any worker who has been employed by the contractor or any sub-contractor for the purpose of performing the contract or sub-contract for work done in the performance of the contract or the sub-contract; or
> (d) any other affected beneficiary in respect of a claim arising out of the performance of the contract or any sub-contract thereunder;
> the retention by the owner of a sum equal to the sum so paid by him shall be deemed not to be an appropriation or conversion thereof to or for his own use or to or for any use not authorized

by the trust if, prior to the retention, all beneficiaries of the trust entitled under him have been paid in full.

The question which arises from section 5(4) is why any 'new money' the owner uses to make a direct payment to a beneficiary of the trust should not simply be regarded as an amount thereupon added by the owner to the trust fund created by section 5(2) of the Act. In its 1979 report, the MLRC recommended against enabling an owner to repay himself if he has advanced his own money from sources other than the project financing obtained to pay claimants to the trust.[90]

ISSUE FOR DISCUSSION #9

a) Should section 5(2) of the Act be expanded to include all funds obtained or used by the owner to pay for a given construction project?
b) In your view does section 5(4) of the Act serve a useful purpose?

d) Loan Repayments

Section 6(1) of the Act provides for recovery from trust funds of sums borrowed by a trustee and paid to a beneficiary. However, there is a lack of guidance in the Act as to when and from whom such recoveries might be made.

Proper accounting principles require that recovery of sums borrowed and paid to a particular beneficiary should subsequently be recovered only from trust money that would otherwise be due to that particular beneficiary.

ISSUE FOR DISCUSSION #10

Should recovered sums borrowed and paid by a trustee to a particular beneficiary subsequently be recovered only from trust money that would otherwise be due to that particular beneficiary?

[90] Manitoba Report, 1979, *supra* note 2 at 46.

e) Assignment and Co-Mingling of Trust Funds

An issue for consideration of the Commission is trustees' obligations under the Act regarding banking practices and, specifically, the depositing and disbursal of trust funds. Of particular interest is the use of general accounts and the assignment by a trustee of its accounts receivable-related practices that have often been dealt with contemporaneously by Courts.

i. Co-Mingling of Trust Funds

Manitoba's Act is silent on a trustee depositing trust funds into a general account or otherwise co-mingling them with either the trustee's own funds or those from other construction projects.

The construction liens legislation of most provinces does not expressly require the segregation of trust funds from other funds or establish record keeping requirements for monies held in trust. The *Builders Lien Act* of British Columbia expressly provides that co-mingling of trust funds does not alone constitute a breach of trust under that statute.[91] Recent amendments in Ontario, which will come into force upon proclamation, require trustees to maintain detailed records accounting for deposit of trust funds on each construction project as well as subsequent disposition of such funds. Such deposits are deemed to be 'traceable'. If trust funds from more than one project are deposited into a single account, and records are kept in accordance with the statute, such co-mingling is not to be considered a breach of trust.[92] The Ontario Act does not mention trust funds deposited serving as collateral for loans benefitting the trustee. Manitoba's Act does not contain guidance on the issue like the Acts of British Columbia and Ontario.

Courts have held trustees under the Act to be in breach of their trust obligations for co-mingling trust funds on a project with other funds in certain situations. In *Glenko Enterprises Ltd. v. Keller et al.*[93], the Manitoba Court of Appeal considered when co-mingling of trust funds with other funds may give rise to a breach of trust and concluded that a breach occurs when the trust funds are deposited in such a way that they are placed at risk. While this important Manitoba decision dealt more with the matter of assignment of trust funds, and will be considered further in the following pages, the Court of Appeal did not find the defendant to be in breach of its trust obligations simply due to the co-mingling of trust funds but rather, because the specific manner in which the trustee had structured its finances placed the trust funds at risk. At paras. 71 and 89, Huband, J.A., writing for the majority, states:

> [71] It may well be that the simple act of depositing trust funds into a general account would not constitute the taking of a risk, which risk was known to be one which there was no right to take. Where the general account is not overdrawn, and where the contractor does not use the trust funds for other purposes, but rather pays the beneficiaries their entitlement without delay,

[91] BC Act, *supra* note 85, s 11(7).
[92] *Construction Act*, *supra* note 57, s 8.1.
[93] *Glenko*, *supra* note 28.

> it might well be concluded that there was little risk, and whatever risk was involved was one which the trustee was entitled to take under the circumstances. But the circumstances in the present case suggest that the risks were high and that Keller Contractors had no right to take such a risk.
>
> …
>
> [89] … I reiterate my earlier observation that the mere fact of depositing trust funds along with other funds in a general account is not necessarily a breach of trust. It becomes a breach of trust only where the trust funds are at risk, as where the contractor operates on bank credit, or where the trust funds are used to pay obligations of the contractor other than the obligation to its trust beneficiaries. Where trust funds would be placed at risk, it is not too much to require that contractors depart from past practices and maintain a separate account into which trust funds are deposited and out of which trust obligations are satisfied. [emphasis added]

This same issue has also been considered by the lower courts in several provinces. In *Arborform Countertops Inc. v. Stellato et al.*[94], the Ontario Court (General Division) considered similar facts to those in *Glenko* and held that a failure to set up a proper system to receive, monitor and disburse trust funds was sufficient to constitute a breach of the statutory construction trust. The contractor in that case was using one account for all expenses and deposits.

In *St. Mary's Cement Corp. v. Construc Ltd.*[95], the Ontario Court of Justice considered the issue of whether a failure to segregate trust funds amounted to a breach of trust. Molloy, J. stated:

> [35] […] Although there is no specific requirement in the [Construction Lien] Act that trust funds be segregated in a special bank account, a contractor who deposits trust funds into a general business bank account and intermingles them with funds from other sources does so at its peril.
>
> [36] […] In my opinion, the Act contemplates a separate trust fund for every project in which the contractor is involved and separate accounting for every trust fund. It is only by separately accounting for the monies held in trust that a contractor can ensure that trust monies are not in fact applied to other purposes. The fact that the Act does not expressly require that trust funds be kept separate from the general accounts of the contractor is not determinative of whether a failure to do so constitutes a breach trust. A trustee has an obligation to protect the trust funds. Allowing trust funds to be intermingled with other monies and used for general purposes is inconsistent with the trustee's duty to maintain proper control of the trust funds: see Re Air Canada and M&L Travel Ltd. […] [emphasis added]

The statements made in the sections emphasized above in *St. Mary's* were repeated by Justice Molloy in *RSG Mechanical Inc. v. ABCO Construction Inc*.[96]

[94] 29 OR (3d) 129, [1996] OJ No 1275.
[95] 32 OR (3d) 595, [1997] OJ No 1318.
[96] [2000] OJ No 4287 (SCJ), 17.

St. Mary's was distinguished by the Ontario Court of Justice (General Division) in *Tam-Kal Ltd. v. Stock Mechanical*[97]:

> [50] It is to be noted […] that, in St. Mary's, supra, the books and records of the defendant appear to have been deficient in that it was not possible to determine exactly what amounts had been paid in respect of any particular project. […] In addition, I am unable to conclude that the provisions of s. 8 of the CLA require the establishment of separate trust funds for each project. The thrust of s. 8 in my opinion is that all funds received by a contractor or subcontractor by way of payment on a contract or subcontract constitute trust funds and cannot be applied by the contractor or subcontractor for its own use or for any other purpose until all subcontractors and suppliers have been paid in full. Although it may be the preferable practice to establish a separate trust account for each project, in my view, a contractor or subcontractor has satisfied the onus placed upon it if it can establish that, in respect of a particular project, it has paid out to subcontractors or suppliers on that project an amount equal to or more than the trust funds it has received in respect of that project and it is not necessary that every dollar received by the contractor in respect of a particular project be directly traceable to a payment to a trust fund beneficiary in respect of that particular project.

The case law appears consistent that the action of depositing trust funds into a general operating account in and of itself is not a breach of a trustee's statutory obligations. However, the case law is inconsistent on what steps are necessary for a trustee to abide by its statutory obligations in such a situation. Based on *Glenko,* co-mingling trust funds is a breach of trust only where the trust funds are placed at risk. There does appear to be uncertainty, however, in the law on what specifically constitutes a risk that would amount to a breach of the statutory trust under the Act. Additionally, the Manitoba courts have yet to consider the level of detail required in record-keeping of funds received and disbursed out of a general account to satisfy the trustee's obligations. This will be considered further in this chapter.

Manitoba courts have rejected the argument presented by trustees that a breach of trust for mingling trust funds with general revenues and using the funds for personal use is negated by the fact that it is a practice used industry-wide. In *Glenko,* the Court of Appeal stated:

> [89] … it was argued that in operating a single general account in which trust funds became mixed with other funds and out of which the contractor's obligations were paid, Keller Contractors was following the practice in the industry. In her reasons for decision at trial in the earlier litigation, Beard J. makes the comment that "[to] the extent that the cases to which I referred dealt with this issue, it appears that this type of banking arrangement is the most common practice in existence in the construction industry." Not that it matters, for whatever the industry practice may be, it cannot excuse the appropriation of trust funds contrary to the provisions of *The Builders' Liens Act.*

[97] [1998] OJ No 4577.

Similarly, in *MG Electric Ltd. v. (CSE) Control Systems Engineering Inc. et al.*[98], the Manitoba Court of Queen's Bench rejected the argument from the principal of the bankrupt contracting company that co-mingling of trust funds with general revenues is a general industry practice and therefore cannot result in personal liability to an officer.

Because co-mingling of trust funds can jeopardize tracing and recovery of funds, legislatures sometimes seek to enhance the position of affected beneficiaries by the use of "deeming provisions such as the following provision contained in *The Pension Benefits Act*:

> **Trust for contributions**
> 28(1) Any sum received by an employer from an employee pursuant to an arrangement for the payment of such sum by the employer into a pension plan as the employee's contribution thereto shall be deemed to be held by the employer in trust for payment of the sum after his receipt thereof into the pension plan as the employee's contribution thereto, whether or not the amount thereof has been kept separate and apart by the employer and the employer shall not appropriate or convert any part thereof to his own use or to any use not authorized by the trust. [emphasis added]

Similarly, it may be appropriate that such a deeming provision be incorporated into *The Builders' Liens Act* whereby any sum received by the trustee pursuant to the statutory trust scheme shall be deemed to be held by the trustee in trust for payment in accordance with the terms of the trust whether or not the amount has been kept separate and apart by the trustee. Other options may include the use of bonds or the creation and administration of an assurance fund by the industry.

The Commission is interested in whether the current common law on the co-mingling of trust funds from construction projects with the trustee's own funds or those of other projects offers appropriate guidance in the opinion of legal practitioners and players in the construction industry or whether statutory guidance, like that contained in the Ontario and British Columbia legislation is warranted.

ii. Assignment of Trust Funds- subsections 6(3) and (4)

The Act contemplates circumstances where the assignment of trust funds can be compatible with the purpose of the trust scheme of the Act. The Act expressly provides for assignment of trust monies by trustees and describes the effect of such an assignment. Sub-section 6(3) provides that no assignment by a contractor or subcontractor of monies due or to become due on account of a contract price is valid against any lien or trust created by the Act. Sub-section 6(4) expressly sustains the trust character of funds which are the subject of any such assignment and expressly makes the assignee the trustee of such funds.

In practice, the assignment of trust funds generally arises when an owner, contractor, or sub-contractor acquiesces to the application of trust funds deposited into its account to an overdraft held by a financial institution or where the financial institution is provided with a general

[98] 2004 MBQB 145 at 21, aff'd 2004 MBCA 178.

assignment of book debts entitling the lender to register the security interest granted and thereby obtain priority over unregistered claimants. Section 6(4) of the Act, which makes all assignments of trust funds by trustees subject to a trust has not been successfully enforced against lenders in Manitoba.[99]

Other than sub-sections 6(3) and 6(4) described above, the Act provides no other guidance on under what circumstances an assignment of trust monies is proper and when it would amount to a breach of trust. The Act does expressly provide, however, that a trustee shall not appropriate or convert any part of the trust fund to or for his own use or to or for any use not authorized by the trust until all of the beneficiaries of the trust have been paid.

It may be that borrowing money on the security of a specific account receivable could come within the borrowing exception in section 6(1) titled 'Protection of Money Lenders' discussed in chapter 2. This provision allows a trustee who has borrowed money and used it to pay a beneficiary of the trust to then use trust money to discharge the loan. It may also be that an assignment by the owner/trustee of project trust funds to a bonding company to ensure completion of the project in the event of a contractor's default may be a use that is compatible with the object of the trust.

On the other hand, trustees are not entitled under trust law principles to engage in risky banking practices or treat trust money as if it is their own property available for their own general purposes.[100] There have been cases where trustees (or their directing officers in their personal capacities) have been found liable for breach of trust when trust funds have been converted to lending institutions under an assignment of book debts or where trust funds were put at risk and ultimately used to satisfy the debts of the trustee.[101]

In *Glenko,* the corporate defendant, Keller Contractors Ltd. sub-contracted work to the plaintiff, Glenko Enterprises Ltd. Glenko registered a lien against property for unpaid work and brought an action against both the contractor and the contractor's financial institution. Pivotal to this decision, the contractor had one operating account with the bank into which it deposited all income from construction projects and paid all expenses- including sub-contractors' invoices. The contractor had arranged a line of credit with the bank and the bank covered overdrafts up to an authorized amount without further approval. After determining that the contractor was in trouble, the bank closed the account and applied the funds towards the line of credit.

After the sub-contractor was unsuccessful in enforcing judgment against the contractor corporation and in its claim against the bank for knowing receipt of trust funds, it sued the corporate contractor's principal, Ernst Keller, in his personal capacity. On appeal of the trial court's decision

[99] See, for example in *Provincial Drywall, supra* note 43, and *Glenko Enterprises Ltd. v. Bank of Montreal*, [1996] 110 Man R (2d), 271996 CanLII 7293 (MB CA).
[100] *Air Canada*, *supra* note 74.
[101] See, for example, *Glenko, supra* note 28, *Scott v Riehl* (1958), 15 DLR (2d) 67 (BCSC), 1958 CanLII 257.

to reject Keller's summary judgment motion, the Court of Appeal considered the banking practices of the contractor as trustee.

The majority of the Court of Appeal held that the fact that trust funds, which had been deposited into a general account, were at risk of seizure was a use incompatible with the trustee's obligations. Huband, J.A. writing for the majority, stated:

> [85] … The breach of trust occurred when Glenko's funds were put at risk, and in the circumstances of this case, that was when the funds were deposited in the general account. The actual loss occurred later, when the bank seized the moneys in the account in partial satisfaction of the corporation's debt to the bank. At that point, it became clear that Keller Contractors could not pay Glenko the moneys to which Glenko was entitled. The defendant Ernst Keller should not have been surprised that the risk which Keller Contractors courted came to fruition. The use of Glenko's funds is a wrongful appropriation of trust funds which is directly contrary to the specific prohibition set forth in s.4(3) of *The Builders' Liens Act.*[102]

In *Glenko,* the majority of the Court relied on the decision in the *Air Canada*. While not a builders' lien matter, the Supreme Court of Canada provided direction on a trustee's obligations respecting banking practices. In *Air Canada,* Iacobucci J. concluded that a travel agency was guilty of a dishonest and fraudulent breach of trust for depositing trust funds belonging to Air Canada into a general account which was later seized by the bank to pay off the agency's debts. At pp. 826-27, Iacobucci J. stated:

> By placing the trust monies in the general account which were then subject to seizure by the Bank, M & L took a risk to the prejudice of the rights of the respondent beneficiary, Air Canada, which risk was known to be one which there was no right to take. See *Baden, Delvaux, supra*; *Scott v. Riehl, supra*. Therefore, the breach of trust by M & L was dishonest and fraudulent from an equitable standpoint.

In both *Glenko* and *Air Canada,* the fact that the trust funds were available to the bank for seizure was a likely risk that constituted a breach of trust.

This raises the issue of what uses are compatible with a trustee's statutory, common law and equitable obligations. Specifically, it raises the issue of in what circumstances an assignment of construction contract accounts receivable to lending institutions to stand as collateral securing the trustee's loans is an assignment of trust funds compatible with either the purpose of the Act or common law fiduciary duties. What ought to be the scope of the assignee's obligations pursuant to trust beneficiaries?

[102] Huband, J.A.'s conclusions in para. 85 above were relied upon by the trial judge in finding the individual defendant in breach of trust after the matter was returned to the Court of Queen's Bench in 2006 MBQB 161 at para. 28.

ISSUE FOR DISCUSSION #11

Are amendments to the Act necessary to address matters concerning assignment and co-mingling of trust funds by a trustee under the Act?

Should the Act be amended to require trustees to maintain detailed records accounting for deposits and dispositions of trust funds like the provisions contained in Ontario's new Act?

How, if at all, should the legislature address use of trust funds as collateral for loans?

f) Records

Section 10 of the Act currently sets out obligations for every contractor and sub-contractor to maintain certain records in respect of each contract or sub-contract "by virtue of which a lien may arise"[103] in their place of business for not less than a year.[104] Note that this section specifically refers to liens but does not impose record-keeping requirements on trustees.

The Act stipulates that records must be kept current on a monthly basis at a minimum[105] and separate records must be maintained in respect to each separate contract and sub-contract.[106] Sub-sections 10(6) and 10(7) of the Act establish that contraventions of the aforementioned record-keeping obligations constitute an offence subject to punishment:

> **Offence**
>
> 10(6) Every person who contravenes or fails to comply with a provision of this section is guilty of an offence and liable, on summary conviction, to a fine of not more than $500. or to imprisonment for a term of not more than three months, or to both and every director or officer of a corporation who knowingly assents to or acquiesces in an offence by the corporation under this section is, in addition to the corporation, guilty of the same offence and liable, on summary conviction, to a similar penalty.
>
> **Continuing offence**
>
> 10(7) Where a person contravenes or fails to comply with a provision of this section for a period of more than one day, he is guilty of a separate offence for each day that the contravention or failure to comply continues.

[103] *supra* note 1, s 10(1).
[104] Ibid, s 10(3).
[105] Ibid, s 10(2).
[106] Ibid, s 10(4).

Reference is made in section 10(5) to production of records to any inspector appointed under *The Labour Administration Act*[107].

> **Requirement to produce to inspector**
>
> 10(5) A contractor or sub-contractor shall produce the records required to be kept under subsection (1) to any inspector appointed under The Labour Administration Act, including a chief inspector, upon his request and make them available for his inspection and shall furnish copies of any part thereof to the inspector upon his written demand.

It may be useful to know whether such inspections actually occur.

The Act currently makes no reference in the above-cited sections or elsewhere to records being maintained for disclosure or release of information to beneficiaries of the trusts provided for in the Act.

ISSUE FOR DISCUSSION #12

Should the record-keeping obligations be extended to trustees under the Act?

Should other modifications be made to the record-keeping obligations currently set out in section 10 of the Act?

4. Liability for Breach of Trust

Silence respecting civil liability associated with a statutory trust tends to mislead. Stakeholders are reminded that breach of trust under the Act can give rise to civil liability and has done so.[108] A beneficiary whose interests are wrongfully damaged by a trustee can sue seeking to trace and recover the trust money in question (action *in rem*) and/or can seek a personal judgment against the wrongdoer for resulting damage (action *in personam*).

Section 13 of Ontario's new *Construction Act*, to be proclaimed, provides express civil remedy descriptions which refer to:

- ordinary civil rights of action as against individual trustees,
- the basis for civil liability of directors and officers of a corporation who knowingly assent to or acquiesce in a breach of trust,
- provisions for joint and several civil liability where more than one person is found liable,

[107] CCSM c L20.
[108] *supra* note 101.

- a right for a person found liable of breach of trust to sue and obtain an order for contribution or indemnity in appropriate circumstances against other persons also found liable for the breach.

Consideration should be given to whether such express references to remedies ought to be incorporated into Manitoba's legislation.

Section 8 of the Act establishes a limitation period for an action to recover the actual trust money to 180 days from the date upon which knowledge of the breach is acquired. This may be a reasonable time limit since money lost for more than 180 days is likely out of reach and impossible to re-take.

Where a party is seeking not the recovery of the actual trust money but judgment against the defaulting trustee personally to compensate for damages suffered, the applicable limitation period for commencement of an action is six years.[109] It seems that six years as a limitation period for commencement of an action for a personal judgment is unduly long in the context of this Act. Consideration could be given to a shortened time period in this regard.

ISSUE FOR DISCUSSION #13

Do you believe that provisions similar to those contained in section 13 of Ontario's Act described above regarding actions for breach of trust should be incorporated into Manitoba's Act?

Would you recommend a limitation period other than 6 years for commencement of an action *in personam* where a party seeks a money judgment against an individual, officer or director of a corporation for breach of trust under the Act?

Section 7 establishes that a breach of trust is a summary conviction offence, as discussed in Chapter 2 of this Paper. Consideration could also be given to recommending that the summary conviction offence and penalty provisions be expanded to allow for an order of restitution in favor of any beneficiary of the trust who has suffered loss as a result of breach of trust by the convicted offender.

ISSUE FOR DISCUSSION #14

Should section 7 be expanded to allow for an order of restitution in favour of any beneficiary of a trust who has suffered loss as a result of a breach of trust by a convicted offender?

[109] *The Limitation of Actions Act*, CCSM c L150, s 2(1)(i).

5. Extending Certain Rights of General Application to Trust Beneficiaries

a) Accounting for Direct Payments Made

Section 30 of the Act sets out a process by which an owner or contractor is entitled to over-step the bounds of privity to directly pay a just debt to a lien claimant:

> **Payments in good faith without notice of lien**
>
> 30 Where an owner or a contractor chooses to make payments to a person referred to in section 13 for or on account of a debt justly due to the person for work done, services provided or materials supplied to be used as mentioned in section 13, and within three days afterwards gives, by letter or otherwise, to the contractor or his agent, or to the sub-contractor or his agent, as the case may be, written notice of the payments, the payments shall, as between the owner and the contractor or as between the contractor and the sub-contractor, as the case may be, be conclusively deemed to be payments to the contractor or sub-contractor, as the case may be, on his contract or sub-contract generally, but not so as to reduce the amount required to be retained by the owner under section 24.

The critical words set out in the heading are, inadvertently, it seems, not reflected in the section as there is no requirement that a payment be made "in good faith" and "without notice of lien".

Section 30 allows the payer who makes a direct payment to obtain proper lien credit from the person in the payment chain who *should* have paid the account. The section makes no reference, however, to the effect of direct payments within the trust scheme of the Act.

To address the mislabelling of the heading and to expressly provide for the appropriate integration of trust and lien provisions, section 30 could be revised to state the following:

> 30 (1) – *Direct Payment Made on Account*
> Where no registered lien is in effect and holdback is retained in accordance with section 24, an owner or a contractor may choose, in *good faith*, to make a direct payment to a trust beneficiary whether or not the claimant is also entitled to a lien on account of a debt justly due to that person under a contract or sub-contract.
>
> 30(2) – *Notice of Payment*
> The payer under section 30(1) shall immediately give written notice of the direct payment made to the person who was contractually bound to make that payment but has failed to do so.
>
> 30(3) – *Credits to accrue*
> A direct payment made under section 30(1) shall be accounted for as trust money earned and duly paid and the value of all affected claims for lien shall be reduced by the amount of the payment made.

ISSUE FOR DISCUSSION #15

Do you agree that the crediting of payors under section 30 of the Act should extend to owners, contractors, and sub-contractors who make direct payments of trust monies to trust beneficiaries?
Do you agree with the language proposed above?

b) Rights to Information

Section 58 the Act currently addresses only the rights of 'persons entitled to a lien' setting out details of the kind of information that can be requested and must be provided by the owner, contractor, sub-contractors, mortgagees and unpaid vendors upon demand. However, these rights to information extend only to "persons entitled to a lien". The same entitlement is not currently granted to beneficiaries of a trust created under the Act:

> **Particulars of contract, etc.**
> 58(1) Any person entitled to a lien in respect of work done or to be done, services provided or to be provided, or materials supplied or to be supplied in the performance of a contract may, in writing, at any time demand from the owner or his agent and the contractor or his agent
> (a) a copy of the contract between the owner and the contractor if the contract is in writing and if the contract is not in writing, a statement of the terms of the contract;
> (b) a statement of the state of accounts between the owner and the contractor;
> (c) the name and address of the bank, trust company or credit union in which a hold back account has been opened where required in accordance with this Act and the account number thereof; and
> (d) a statement as to the particulars of credits to and payments from the hold back account required in accordance with this Act including the dates of the credits and payments, the accrued interest and the present balance.
>
> **Particulars of sub-contract, etc.**
> 58(2) Any person entitled to a lien in respect of work done or to be done, services provided or to be provided, or materials supplied or to be supplied in the performance of a sub-contract may, in writing, at any time, demand of the contractor or his agent and the sub-contractor and his agent
> (a) a copy of the sub-contract between the contractor and the sub-contractor or between the sub-contractor and another sub-contractor, if the sub-contract is in writing and, if the sub-contract is not in writing, a statement of the terms of the sub-contract; and
> (b) a statement of the state of accounts between the contractor and the sub-contractor or between the sub-contractor and the other sub-contractor, as the case may be.
> **…**

Order to produce

58(6) On application at any time before or after an action is commenced for the realization of a lien, a judge may make an order requiring the owner or the contractor, or a mortgagee, or an unpaid vendor, or a sub-contractor or the agent of any of them, as the case may be, to produce to any person who may be entitled to a lien in respect of work done or to be done, or services provided or to be provided, or materials supplied or to be supplied in the performance of a contract or sub-contract in respect of land, and permit that person to inspect the contract or sub-contract or the mortgage or agreement for sale of the land, or the accounts, or the hold back account pass book, or any other relevant documents and he may make such order as to costs of the application and order as he deems just.

It is suggested that sub-sections 58 (1) through (6) require careful review to integrate trust and lien provisions in the Act and expressly include 'any beneficiary of a trust created by the Act whether or not entitled to a lien'.

The list of documents and information in section 58(1)(b) and like provisions could be expanded to require 'statements of accounts' to expressly include: the dates, full particulars for each progress claim submitted and reviewed, amounts in the schedule of values claimed denied, certified or otherwise approved for specific beneficiaries of the trust and paid plus details respecting all payments pending.

Section 58(6), which provides for a judge to order production of documents in an action to realize on a lien, also requires amendment to expressly include actions under the Act for breach of trust.

ISSUE FOR DISCUSSION #16

Should current rights to information for persons entitled to a lien be extended to trust beneficiaries? Should the information to be produced or delivered pursuant to section 58 of the Act be expanded to provide full particulars respecting the payment claim and certification process?

CHAPTER 4- LIEN PROVISIONS IN THE ACT

The MLRC has identified a number of issues with the current lien provisions of the Act requiring consideration and consultation.

1. 'Value' of Lien Claim

Section 13 of the Act states that a lien arises in performance of a contract or sub-contract "for the value of the work, services or materials" provided. There is little guidance in the Act, however, as to how the 'value' or the claimable amount of a lien is to be calculated. Case law in Manitoba has determined that damages are not to be included in such calculations.[110] Sub-section 40(a) of the Act helpfully states that liability may result if a person registers a claim for lien "for an amount grossly in excess of the amount due to him or which he expects to become due to him".

It may be beneficial for the proper calculation of the valuation of a lien claim to be expressly provided for in the Act. One such option would be the addition of a new subsection to section 13 providing:

> 13(…) *Value of lien claim*
> The claimable value of a lien at a given point in time includes the amount then due or reasonably expected by the claimant to become due under its contract or sub-contract for work done, services provided and materials supplied, and does not include any amount for damages caused by others.

ISSUE FOR DISCUSSION #17

In your view is it useful to include a definition of 'value' for lien claims as proposed?

2. Wage Earners as Lien Claimants

Section 34 of the Act provides that workers or wage earners employed by a contractor or sub-contractor on a construction project are entitled not only to register builders' liens but are also given a priority over all other lien claimants to the extent of forty days wages. Similarly, wage earners have priority over other lien claimants in most provinces for between thirty and forty days' wages.[111]

[110] See *Gardon Construction Ltd. v. McConnell (c.o.b. J.R.S. Contracting Services)*, [1993] MJ No 378, 89 Man R (2d) 21 at 25. The Manitoba Court of Queen's Bench held that "off-site concrete plant standby charges and winter operating costs" were in the nature of damages and not in the circumstances properly included in the lien claim.

[111] Only Newfoundland, Prince Edward Island, Quebec and Nunavut do not allow for a wage earner's claim for a certain number of days to take priority over other lien claimants.

As discussed in Chapter 3, claims under the Act from wage earners rarely, if ever, occurred as long ago as 1979 when schemes now in the Act were last the subject of legislative review.[112] As the MLRC's 1979 Report stated at the time, Manitoba's labour laws have developed better, faster and more effective remedies for this class of potential trust and lien claimants. In contrast, lien provisions are particularly costly, slow and are not geared to the urgency of a worker's situation when wages are not paid and regular living costs such as food, rent and transportation must be met.

Lien claims from wage earners are currently reported to be unheard of at Winnipeg Land Titles office.

ISSUE FOR DISCUSSION #18

Should wage earners remain or be removed from the remedial payment scheme in the Act which is based on registration and enforcement of builders' liens?

3. Holdback Account & Interest Entitlement

The term *holdback* is defined in section 1(1) of the Act to include interest "where the holdback is deposited in a holdback account". The defined term *holdback account* means "an interest bearing account in a bank, trust company or credit union in the joint names of the owner and contractor". When interest rates are low, provisions in the Act requiring payment of interest on holdback do not seem important. If/when interest rates significantly increase, this issue will regain prominence.

Section 24(3) states that holdback retained by the person primarily liable on the contract (i.e. the owner) is to be deposited into a holdback account where the contract price exceeds an amount prescribed by regulation. The prescribed amount is currently set at $200,000.[113] The Commission is aware of reports that owners most often simply retain holdback *without* setting up an interest bearing account jointly with the contractor.

Section 24(6) also relies upon the above Regulation to fix $200,000 as the threshold contract price over which the Crown must calculate and pay interest on holdback at rates set out in the Regulations.

[112] Manitoba Report, 1979 *supra* note 2 at 27.
[113] Man Reg 127/1989, s 2.

ISSUE FOR DISCUSSION #19

In your view is the current requirement to set up a joint account in the names of owner and contractor a useful provision which should be sustained?

Is the more important requirement that holdback should be retained in an interest bearing account?

In your view should the obligation to accrue and pay interest on holdback only apply above a threshold contract price? Is $200,000 the appropriate threshold or should some other value trigger this requirement?

4. Crown, Crown Agencies & Application of the Act

Manitoba's *Builders' Liens Act* has no application on a constitutional basis to federal government construction projects which are beyond the reach of provincial legislation.

The Legislature has provided in section 3(1) that the Province of Manitoba, all provincial crown agencies listed in section 1(1)[114], and all boards, commissions and bodies performing duties and functions under an act of the Legislature on behalf of the Crown (including municipalities) are bound by the Act. Lien provisions are modified in section 16 to charge holdback but not title to the land in such cases.

Section 3(2) excludes from the Act entirely all construction projects for the Crown respecting highways, bridges, air strips, docks and ferry terminals under the control and management of the Crown. A separate statute, *The Highways and Transportation Construction Contract Disbursement Act*[115], borrows some concepts from the Act to set up a summary dispute resolution procedure which is, reportedly, rarely used. Section 3(3) of the Act expressly excludes from application of the Act Manitoba Hydro contracts associated with hydro-electric generating stations or facilities and plant appurtenant thereto.

Private-public financing of construction projects in Canada, such as P3s, has often involved large highway and bridge projects. It therefore could be that high value highway projects under complex project delivery models will be part of the future in Manitoba. Stakeholders might wish to reflect on the advisability of recommending that the reach of the Act be extended to include such future projects.

[114] For the purpose of the Act, Crown Agencies include: Manitoba Agricultural Services Corporation, The Manitoba Public Insurance Corporation, Manitoba Development Corporation, The Manitoba Housing and Renewal Corporation, Manitoba Hydro, Manitoba Liquor and Lotteries Corporation, and The Manitoba Water Services Board.
[115] CCSM c H65.

ISSUE FOR DISCUSSION #20

Do you think that present inclusions and exclusions of Crown and Crown-related construction projects from the Act are satisfactory? What, if any, changes should be considered in this regard, and why?

5. Special Concessions for Public Mega Projects

Extremely high value, long duration public mega projects which fall within the Act incur significant extra cost when required to deduct and retain 7.5% of the contract value until substantial performance can be achieved. The contractor and the sub-contractors are denied access to large value holdbacks accruing for several years of lengthy projects. Costs to the public owner increase accordingly.

The Act offers no accommodation for such 'solvent' public owners. This could influence Crown decisions on which infrastructure projects are to be excluded from the Act. Exclusion denies the construction industry access to the full range of benefits and payment protections included in the Act.

Consideration should be given to whether reform in this area is necessary and beneficial. By regulation, a minimum contract value for high value projects and the duration of eligible projects could be specified for exceptional treatment of the holdback requirements in the Act, such as:

- staged release (such as annually) of holdback accrued without regard to achievement of substantial performance;
- permission to substitute a suitable form of security such as irrevocable letters of credit to stand in place of cash in the holdback account; and
- exemption entirely from the requirement to retain holdback provided that a bond (in acceptable form from an acceptable surety) is posted in an appropriate amount to stand as a special fund to satisfy potential lien claims.

Note that recent amendments in Ontario to their *Construction Act*, once proclaimed, will permit letters of credit, holdback bonds and any other form of security prescribed to be used as holdback.[116] Further, new sections 26.1 and 26.2, respectively, allow for annual and/or phased release of holdback on projects of long duration and with values prescribed in regulations to the Act.

[116] *Construction Act*, *supra* note 57 at s 22.

ISSUE FOR DISCUSSION #21

Should separate holdback provisions be developed for high value long term construction projects? Have Stakeholders encountered other holdback solutions on extremely large public projects which merit further consideration and possible recommendation in the Commission's final report?

6. Substantial Performance

a. Valuation of Substantial Performance

Section 2(1) (b) of the Act sets out a formula for valuation of work remaining when assessing whether a contract has been substantially performed. Together with other criteria set out in section 2(1) (a), a certificate can issue if the cost to complete is not more than:

(i) 3% of the first $250,000 of the contract price,
(ii) 2% of the next $250,000 of the contract price, and
(iii) 1% of the balance of the contract price.

These values have not been revised since 1981.

In contrast, since 1983, Ontario's Act has stipulated that a certificate can issue where the cost to complete is not more than 3% of the first $500,000, 2% of the next $500,000 and 1% of the remainder of the contract price.

In the recent Ontario Report, a Bank of Canada inflation rate of approximately 120% from 1983 to 2016 was relied upon for the recommendation that a contract ought to be deemed 'substantially performed' where it is capable of completion at a cost of no more than 3% of the first $1,000,000, an increase from $500,000, 2% of the next $1,000,000, increased from $500,000, and 1% on the balance.[117] The recommended increases have now been enacted in Ontario.[118]

ISSUE FOR DISCUSSION #22

In your view, should the valuation of work to be completed for a contract to be substantially performed in section 2(1) (b) of the Act be amended and, if so, to what values?

[117] Ontario Report, *supra* note 3, at 68.
[118] *Construction Act*, *supra* note 57 at 2(1)(b).

b) Posting Certificates of Substantial Performance

A certificate of substantial performance for a contract must be given to the owner, contractor, or, where the certificate relates to a sub-contract, to a sub-contractor pursuant to section 46 of the Act. Giving the certificate to its intended recipient acts as the trigger for time beginning to run under section 24 and section 25 for release of holdback. Similarly, providing the certificate to its recipient also commences the time period within which a claimant may register a claim for lien under section 43 and section 44 of the Act.

Unlike some Canadian jurisdictions, the Act does not require any public notice of the date or fact that a certificate of substantial performance has been given.[119] Notice of this information is critical to the timely exercise of lien rights for every lien claimant on each project.

There are various methods for publication of the date and fact of issuance of certificates of substantial performance. Publication in a local newspaper is an option. Posting a copy of the certificate in a prominent location on the work site is another. It may be that postings on local construction association web-sites could be considered for such purpose. Winnipeg Land Titles Office officials have suggested that registration on title of a certificate giving notice in a form satisfactory to the Registrar General may be the best solution, but that would leave Crown projects that are subject to section 16 of the Act and work sites identified in registries other than the Land Titles Office registry in need of separate solutions.

ISSUE FOR DISCUSSION #23

Do you believe that a public notice should be a requirement for each certificate of substantial performance issued? If not, why not? If so, what method(s) of notice do you think would be most suitable?

7. Small Liens

Section 14 of the Act sets the minimum amount for lien registration at $300.00. In its 1979 Report, the MLRC recommended the minimum be set at $300.00, an increase from the minimum value at that time of $20.00.[120] The minimum lien value has not changed since that time.

In the 1979 report, the MLRC considered the need to reconcile two competing interests: precluding those persons who most need the security of a registered lien from acquiring the legislative

[119] Section 20(1) of the Alberta Act, *supra* note 85 requires a person issuing a certificate of substantial performant to post a signed copy of it on the job site within 3 days from the date the certificate was issues. Sub-section 20(2) imposes liability for legal and other costs for failure to post the certificate within the time requirement. The Ontario Act now requires notice of the certificate to be published in the manner set out in the regulations. (Ontario Act, *supra* note 57 at s 32(1).
[120] Manitoba Report, *supra* note 2 at 103.

protection and the need to ensure the legislation is workable and it is no longer financially feasible to challenge the validity of a petty lien claim.[121]

At the time, the Commission considered recommending the alternative remedy of allowing a lien claimant to sue for a debt in Small Claims Court where a maximum claim value of $1,000.00 was then in effect. It determined, however, that the trial of a lien claim by a provincial government appointee under *the County Courts Act,* as it then was, was not constitutionally proper.[122]

Currently, to vacate, secure and sue to enforce a lien, Court of Queen's Bench proceedings must be commenced at significant cost to the claimant and to others affected by registration of a lien.

There has been concern expressed that increasing the minimum may preclude those who require the protections afforded to lien claimants under the Act from utilizing them. This concern was also raised by the Commission in its 1979 Report.

Recent inquiries at Winnipeg Land Titles Office revealed that of 50 liens recently registered;

- 30% were for lien claims in excess of $20,000,
- 48% were for lien claims between $5,000 and $20,000, and
- 22% were for lien claims of $5,000 or less.

For comparison purposes, builders' lien legislation in some provinces does not contain a minimum lien value.[123] Of those that do, Saskatchewan has a minimum value limit of $100.00 while British Columbia and New Brunswick allow lien claims where one claim or an aggregate of joint claims is $200.00 or more. In Alberta, one or an aggregate of joint claims must be at least $300.00. The Act of Prince Edward Island sets a minimum claim value of $32.00.

If concepts presented in this Paper result in legislative changes, which improve accountability in the payment chain and the timeliness of payment of amounts earned on construction projects, reliance on the lien remedy could change substantially. Under enhanced trust and prompt payment provisions, liens should continue to provide a powerful remedy when severe payment defaults arising from *bad faith* dealings or insolvency of an owner or contractor cannot otherwise be resolved on a given project.

ISSUE FOR DISCUSSION #24

In your view, should a minimum claim value be set by statute for a registrable builders' lien? If so, what is an appropriate minimum value?

[121] Ibid, 102.
[122] Ibid, 103.
[123] See, for example, the *Construction Act* of Ontario.

8. Registration of Liens against Leasehold Estates

Section 18 of the Act permits claims for liens to attach leasehold interests in land:

> **Where estate attached is leasehold**
> 18(1) Where the estate or interest of the owner upon which the lien attaches is a leasehold estate or interest, the estate or interest of that owner's landlord and, where the estate or interest of the owner's landlord is leasehold, the estate in fee simple, as well are subject to the lien if
>
> (a) the person entitled to the estate in fee simple or the owner's landlord, or both, consented to the work, services or materials giving rise to the lien being done, provided or supplied, and the work, services or materials giving rise to the lien were done, provided or supplied for the direct benefit of the person entitled to the estate in fee simple or the owner's landlord; or
>
> (b) the owner is required, by his lease or other agreement with his landlord, or other person entitled to the estate in fee simple to do the work, provide the services, or supply the materials giving rise to the lien.
>
> **Limit of lien**
> 18(2) A lien created under subsection (1) on the estate or interest of an owner's landlord, or on an estate in fee simple is limited to, and does not attach so as to make the owner's landlord or the holder of the estate in fee simple liable for more than the value of the holdbacks that the owner was required to make.

Section 18 provides no direction as to how to effect registration or notice of such claims. While it is possible for a landlord or tenant to register a lease in the local land titles office and obtain a title for such an interest in land, this does not often occur. Notice of such interests in land can also be registered as a caveat on the landlord's title, but this does not always happen. Most often, even in the case of long-term commercial leases, there is no public record to be found which clearly identifies the existence of a lease arrangement, its terms, its parties, etc.

Lawyers faced with this dilemma have been known to register a notice of claim for lien on a leasehold interest against the landlord's fee simple title in the relevant land titles office. The standard form is 'embellished' by expressly stating the claimant's intention to lien not only the landlord's title or estate but also the leasehold estate of the tenant in the same land. Winnipeg Land Titles Office has confirmed that such a registration against a suspected leasehold estate is the best that can be done currently. This review presents an opportunity to consider whether express provisions should be added to the Act to remove any doubt that such a registration or equivalent notice of claim for lien is valid and enforceable.

Section 38 prescribes the information to be contained in a claim for lien:

> **Contents of claim for lien**
> 38(1) A claim for lien shall state
> (a) the name and residence of the person claiming the lien and of the owner of the land to be charged (or of the person whom the person claiming the lien, or his agent, believes to be the

owner of the land to be charged) and of the person for whom and upon whose credit the work was or is to be done, the services were or are to be provided or the materials were or are to be supplied;
(b) the time or period within which the work was or is to be done, the services were or are to be provided or the materials were or are to be supplied;
(c) a short description of the work done or to be done or the services provided or to be provided or the materials supplied or to be supplied;
(d) the sum claimed as due or to become due;
(e) a description of the land to be charged, sufficient for the purpose of registration; and
(f) where credit has been given by the lien claimant for payment for his work or services of materials, the date of expiry of the period of credit.

Form of claim
38(2) The claim for lien may be in Form 1, 2 or 3 in the Schedule, and shall be verified by the affidavit in Form 4 in the Schedule, of the person claiming the lien or his agent or assignee.

Nearly identical information is required for inclusion in a notice of claim for lien where the lien does not attach to land.[124] Prescribed contents for forms under the Act could be revised to expressly contemplate claims against leasehold estates.

ISSUE FOR DISCUSSION #25

Stakeholders are invited to comment on possible improvements to the process for effective registration of liens against leasehold estates.

9. Holdback Percentage

Prior to the MLRC Review in 1979, holdbacks of 15% and 20%, depending upon the contract price, were required to be retained under the former *Mechanics Liens Act*. Stakeholders lobbied for a reduction in these amounts to something closer to their profit margin to free up sums they required to pay for work completed. The result was a holdback of 7.5% which is set out in section 24 of the Act.

This review offers the opportunity for consideration of the 7.5% holdback value which is one of the lowest in Canada. The applicable legislation of Alberta[125], British Columbia[126], Ontario[127], Newfoundland[128], Nova Scotia[129], Saskatchewan[130], as well as the Northwest Territories[131] and

[124] *supra* note 1 at s 45(1),(2)&(5).
[125] Alberta Act *supra* note 85 at s 18.
[126] BC Act *supra* note 85 at s 4.
[127] *Construction Act*, *supra* note 57 at s 22(1).
[128] *Mechanics' Lien Act,* RSNL 1990, c M-3, s 12.
[129] Nova Scotia Act *supra* note 85 at s 13(2).
[130] Saskatchewan Act *supra* note 85 at s 34.
[131] *Mechanics Lien Act*, RSNWT 1988, c M-7, s 6.

Yukon[132] establishes a holdback of 10%. Both New Brunswick[133] and Prince Edward Island[134] have a tiered scheme by which a holdback of 20% applies where the value of work and materials is less than $15,000 and where the value exceeds $15,000, the holdback is set at 15%.

ISSUE FOR DISCUSSION #26

Should Manitoba's statutory holdback continue at 7.5%? If it should be changed, to what percentage, and what would be the expected benefits to Stakeholders and/or the industry?

10. Expiry of Time for Registration of Liens & Release of Holdback

Sections 43 and 44 of the Act establish the time period from certain listed events within which claimants must register (or give written notice) of valid and enforceable liens at **forty days**. This time period also dictates the earliest date for release of holdback after substantial performance has been certified.[135]

The first issue for consideration is whether forty days is an appropriate deadline. In the Ontario Report, it is stated that the mean time for registration of liens in Canada is 44 days compared to 120 days in the United States.[136] Ontario's legislation formerly provided 45 days but has now extended this time period to 60 days.[137]

It may be that forty days has always been too short a time period for lien claimants to assess whether late payments will be made down the payment chain. On the other hand, some are reluctant to extend the time for release of holdback money. It may be that enhanced trust provisions and a prompt payment regime could significantly change the timeliness of payments making lien registration a less frequent or urgent consideration.

ISSUES FOR DISCUSSION #27

What should the time period be for lien registration/holdback release?

What should the period for lien registration/holdback release be if the legislature does not enact recommended trust provision enhancements and a prompt payment regime?

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[132] *Builders Lien Act*, RSY 2002, c 18, s 6.
[133] New Brunswick Act *supra* note 85 at ss 15(1)&(3).
[134] *Mechanics' Lien Act,* RSPEI 1988, c M-4, s 14.
[135] *supra* note 1 at s 25(1).
[136] Mark Adrian de Jong, "*Ontario's Construction Lien Act*: Examining Preservation and Perfection Deadlines in Geographical, Inter-Jurisdictional, and Commercial Contexts – The Case for Extended Deadlines", Journal of the Canadian College of Construction Lawyers, 2013 J. Can. C. Construction Law 133, cited in the Ontario Report *supra* note 3 at p 35.
[137] *Construction Act*, supra note 54 at s 31(2).

11. Vacating Liens

a) Umbrella Lien Concept

On an application for vacation of a registered claim for lien, section 55(2) of the Act requires that security be posted in an amount:

> 55(2) […] not exceeding the total amount of the claims for liens then registered against the parcel of land [...]

It often occurs that several liens will be registered on a single construction project when a serious dispute or payment default occurs. If the contractor or a major sub-contractor is among the lien claimants, it is likely that the value of its lien claim will include amounts that it owes to others below it in the payment chain. Some of the lower chain claimants may register their own liens so that duplicate values are included in the apparent total value of registered liens at issue on the application.

The term 'umbrella lien' has been used to describe the lien of the contractor or sub-contractor that includes amounts owing to other registered lien claimants below them in the payment chain. In order to facilitate the court's determination of the appropriate amount of security required to protect the unduplicated value of registered liens, it is necessary to ensure that no registered lien claim is double counted - once within an umbrella lien and again under the registrant's own claim for lien.

The following definition could be added to section 1(1) of the Act:

> "umbrella lien" means a lien registered by a contractor or sub-contractor which includes in its value amounts that are also claimed in liens registered by persons whose lien claims arose at a lower level of the same construction contract payment chain.

Section 55(2) could also be amended to instead read:

> section 55(2) Upon application, a judge may order security or payment into court in an amount equal to the holdback required under this Act as it applies to a particular contract and any additional money payable with respect to that contract but not yet paid but not exceeding the total unduplicated amount of the claims for liens <u>when taking into account values included in any umbrella liens then registered against a parcel of land</u>...

ISSUES FOR DISCUSSION #28

Should the term "umbrella lien" be a defined term under the Act and should sub-section 55(2) of the Act be amended to ensure that registered lien values included in a contractor or sub-contractor's umbrella lien are not doubly counted?

b) Rights against Security in Place of Land – Reform of Section 56(1) (b)

The security posted on an application made under section 55(2) of the Act to obtain an order vacating one or more registered liens from a land title is subject to section 56(1)(a), a convoluted provision, that states:

> **Money paid into court, etc., in place of land**
> 56(1) Any money paid into court or any security given under subsection 55(2) stands in place of the land against which the lien was registered and is subject to the claims of
> (a) the persons whose liens have been vacated; and
> (b) every person who
> (i) both at the time of filing the application under subsection 55(2) and at the time of filing application for payment out under subsection (3), has a subsisting claim for lien, and
> (ii) has registered a claim for lien prior to the time of filing the application for payment out under subsection (3);
> but the persons whose liens have been ordered vacated have a first charge on the money or security to the extent of any amount, including costs, found by the judge to be owing to them.

The result of section 56(1) is that any money paid into court or security given under section 55(2) stands in the place of the land against which the vacated lien(s) was/were registered; the security posted is subject to the claims of the persons whose liens have been vacated; and the persons whose liens have been vacated have a *first charge* on the security posted to the extent of the amount, including costs, found by a judge to be owing to them.

Where section 56(1) becomes nonsensical and ceases to be effective is by contemplating in section 56(1)(b) another group of persons who might have a lesser right to claim against any surplus after the rights of the vacated lien claimants have been finally determined and judgment has issued in the vacated lien claimant's favour.

Members of the section 56(1)(b) hypothetical group of potential claimants are required to have:

- a subsisting claim for lien both at the time the section 55(2) application is filed and at the time that an application is filed under section 56(3) for payment out of the security posted; and
- a registered claim for lien prior to the time of filing of the application for payment out under section 56(3).

Given the extended time frame typically required for the vacated lien claimant to sue, obtain judgment and then apply under section 56(3) for payment out of the security posted, it is highly improbable that any other registered lien claimants on the same project would then be waiting in the wings anticipating recovery from excess security not required to satisfy the first charge in favor of the vacated lien claimant(s).

Any logic behind the original drafting of section 56(1) (b) is not apparent at this time. No other provisions of the Act explain what the original intention might have been. Working through various fact scenarios leads to no justification for sustaining this second, hypothetical class of potential claimants.

ISSUE FOR DISCUSSION #29

Should section 56(1) (b) be deleted leaving section 56(1) to provide for the secured interest of the vacated lien claimant(s), and expressly providing that the applicant on the section 55(2) application who posted the required security shall be entitled to reclaim any surplus amount posted after determination of the rights of the vacated lien claimant(s)?

12. Materials Supplied

When read together, section 2(3), section 17 and section 35 provide contradicting and confusing messages respecting when a supplier's lien rights arise and to what they attach from time to time. These provisions provide the following:

> **Supplying materials**
> 2(3) For the purposes of this Act, materials shall be deemed to have been supplied to be used in the performance of a contract or a sub-contract
> (a) if they are delivered to land in respect of which the contract or sub-contract is to be performed; or
> (b) if they are delivered to some other land which is in the immediate vicinity of the land in respect of which the contract or sub-contract is to be performed and which has been designated by the owner or his agent as the land to which the materials are to be delivered; or
> (c) if the materials were made to specifications set out in the contract or sub-contract and were delivered to the contractor or sub-contractor for the purpose of being used in the performance of the contract or sub-contract;
> but delivery of materials on land designated under clause (b) does not make the land so designated subject to a lien in respect of the supplying of the materials.
> …
> **Where materials incorporated**
> 17 Notwithstanding the materials supplied to be used in the performance of a contract or sub-contract have not been supplied in strict accordance with subsection 2(3), if the materials are incorporated or used in the construction or the improvement of land to which the contract or sub-contract relates, subject to section 16, the lien created under section 13 attaches to the land or structure.
> …

Removal of materials during lien
35(1) During the continuance of a lien, no portion of the materials affected by it shall be removed to the prejudice of the lien and any attempts at such removal may be restrained on application to a judge.

Costs
35(2) A judge to whom an application is made under subsection (1) may make such order as to costs of, and incidental to, the application and order as he deems just.

Certain materials not subject to execution
35(3) Where any materials are actually placed and furnished to be used in the performance of a contract or sub-contract the materials are subject to a lien in favour of the person supplying them until incorporated in the structure or land under the contract

It is proposed that these three sections be revised to provide as follows:

- Supply of materials by any of the means listed in section 2(3) gives rise to lien rights in the supplier for the value of materials supplied;
- From the time of supply, the supplier's lien forms a charge on the owner's land or, in a case where Crown lands are involved, a charge on the holdback pursuant to section 16 of the Act;
- Supplier lien rights arise upon effective 'supply' under section 2(3), irrespective of whether the materials are yet on the construction site or incorporated in the structure to improve the value of the owner's land;
- Section 17 should be deleted because it instead contemplates incorporation of materials as a requirement for the supplier's lien attaching to the land where the supplies are to be used; and
- Section 35 should be revised to merely prohibit (by possible order of a judge) removal of supplied materials from the supply locations listed in section 2(3) to any destination other than the land to be improved which is subject to the supplier's lien.

ISSUE FOR DISCUSSION #30

Do you agree with the above suggested revisions to sections 2(3), 17, and 35 of the Act?

13. Limitation Period for Enforcement of Liens

The Act provides that a duly registered claim for lien expires unless the claimant commences an action and registers a pending litigation order against title to the land within two years of the date the lien was registered.[138] The same two year limitation period applies where written notice of a claim for lien is given to the owner of a project where the owner is the Crown, a Crown agency, or a municipality, and is, therefore, not subject to registration of lien on the land.[139]

A claimant who registers a lien in good faith and is serious about pursuing enforcement gains no advantage from 'sitting on his rights' for up to two years before suing.

In Ontario, the equivalent limitation period has long been forty-five days from lien registration but under the new amendments, Ontario will extend the time for issuing a statement of claim to 90 days.[140]

ISSUE FOR DISCUSSION #31

Do you think that the current two year time limit to sue on a lien is appropriate or should it be revised?

14. Minor Lien Provision Updates

What may appear to be minor revisions to an existing Act can sometimes produce unintended results. Stakeholders are therefore invited to review the following list of potential minor updates and modifications to the Act and to comment wherever considered appropriate.

a) Liens Charge Holdback

Section 13 identifies the classes of persons entitled to lien rights under the Act[141] and expressly provides that the right attaches to the estate or interest of the owner in the land, except where section 16 precludes charging the project land where the owner of such land is the Crown, the Crown agency, or the municipality. Section 13 does not state that the lien extends to a charge on the holdback as well. However, buried in a distant part of the Act, Section 26 provides:

> **Lienholders charge on holdback**
>
> 26 Each lienholder who has a lien arising under a contract or sub-contract has a charge upon that part of the holdback to which the person through whom the lien is derived is entitled.

[138] *supra* note 1, s 49(2).
[139] Ibid at s 49(4).
[140] *Construction Act*, *supra* note 57, s 36(2).
[141] The classes of persons identified in section 13 entitled to lien rights includes "any person who (a) does any work; or (b) provides any services; or (c) supplies any materials to be used in performance of a contract or sub-contract…".

It is therefore proposed that current section 13 be re-numbered as section 13(1) and that section 26 become section 13(2), as follows:

> Section 13(2) –*Lienholders charge on holdback*
> Each lienholder who has a lien arising under a contract or sub-contract has a charge upon that part of the holdback to which the person through whom the lien is derived is entitled.

b) Typographical Error in Section 23 –Limit of lien claimed by a person other than contractor

Section 23 of the Act provides:

> 23 **Limit of lien claimed by person other than contractor**
> […] where a lien is claimed by a person other than the contractor, the amount that may be claimed in respect thereof is limited to the amount payable to the contractor or sub-contractor or other person for whom the lienholder did work, provided services or supplied materials. [emphasis added]

It is not reasonable to expect a lien claimant to have knowledge of the 'amount payable' to the party above it in the construction contract payment chain at the time of issuing a notice of claim for lien. The limit that the Legislature sought to impose could, however, fully operate at the time of 'recovery' on a claim for lien.

Section 23 could therefore be amended to remove the word 'claimed' and replace it with 'recovered'.

c) Contract/Sub-contract Termination as an Event Marking Time Periods

In sections 24 and 25 of the Act, various events are described from which time for retainage and release of holdback is to be counted. Likewise, section 43 and section 44 of the Act describe events from which to mark time for registration or giving written notice of a claim.

The events described in the above sections expressly include 'completion or abandonment' of contracts and sub-contracts but make no mention of 'termination'.[142]

The Commission is considering whether *termination* of a contract and *termination* of a sub-contract should be added to the lists of events marking time in the sections mentioned above. Stakeholder feedback is requested on this issue.

[142] Recent amendments to Ontario's Act (to be proclaimed) include the addition of "termination" to the list of events from which time for retainage and release of holdback is counted at s 31(2).

d) 'Primary' Holdback and 'Finishing' Holdback

Currently, the Act provides for deduction and retention of 7.5% from each payment made in respect of the total contract price[143] and for partial release of holdback forty days after a certificate of substantial performance has been given.[144] The owner is further required to retain and ultimately release 7.5% of payments made under the contract *after* substantial performance has been certified.[145] No differentiation in language is made between the initial or 'primary' holdback, which accrues prior to issuance of a certificate of substantial performance, and the subsequent or 'finishing' holdback, if any, which may accrue if further amounts on the contract price remain to be paid out after such a certificate issues.

Do you think that expressly naming the two distinct holdback accrual amounts would help to clarify the intent of the current Act?

e) Latin Terminology to Plain Language

Modern statutory drafting principles call for plain language to be used to replace unhelpful archaic legal terminology.[146] While recently drafted statutes have usually abandoned Latin legal maxims, the Act is rife with them. For example, the Latin term *pro tanto*, which appears throughout the Act means 'for so much', 'to that extent' or 'as far as it goes'. The Latin term *pari passu*, which appears in section 33(b) of the Act, means 'rateably', or 'without preference'. Should the above Latin terms be replaced wherever they appear in the Act with their plain language synonyms?

In contrast, there are legal maxims with comparable high levels of familiarity and understanding amongst the legal community and industry who utilizes the Act. The term *pro rata*, for example, means 'proportionately', 'according to a certain rate', or 'percentage or proportion' which dictionary definitions are not particularly helpful. The term *pro rata* is well understood by those who rely on the Act to mean that the percentage share of each lien claimant is based on the ratio of the value of each claim to the total value of claims at issue.

f) Bargains Involving Registered Liens

The Act contemplates the holder of a registered builders' lien negotiating with an owner or perhaps others to extend time for payment, taking a promissory note or taking additional forms of security for the lien.[147] The Act currently provides that such dealings do not destroy the effect of the

[143] *supra* note 1 at s 24(1).
[144] Ibid, ss. 25(1)(a) & 25(2).
[145] Ibid, ss 25(3)& (4).
[146] see for example, Province of British Columbia, Office of Legislative Counsel, Ministry of Justice, *A Guide to Legislation and Legislative Process in British Columbia: Part 2 Principles of Legislative Drafting* (August 2013) at 5.
[147] Section 57(1) provides that a registered claim for lien/notice of lien is not merged, discharged, paid, satisfied, prejudiced or destroyed by (a) the taking of any security for the claim; or (b) the acceptance of any promissory note for the claim; or (c) the taking of any other acknowledgement of the claim; or (d) the giving or extending of time for payment of the claim; or (e) the taking of any proceedings for recovery of the claim; or (f) the recovery of any personal judgment for the claim; unless the lienholder agrees in writing that it shall have that effect.

registered lien unless the lienholder agrees and that a lienholder accepting additional security retains the lien for the benefit of the security holder.[148]

Section 57 of the Act contemplates a degree of marketability of registered liens that may no longer exist. It is difficult to imagine circumstances where a holder of a duly registered claim for lien would want to extend time for payment or to seek any other or better security than the land itself.

Section 57(3) goes on to contemplate the effect of having bargained away a registered lien claimant's entitlement to immediate payment. Where such a bargain has been struck, the lien claimant is directed to commence an action to enforce its lien in time and to register a pending litigation order, but to then 'stay' all further proceedings within that action until agreed terms of extended credit have expired.

Finally, section 57(4) provides that if another lien claimant advances a separate action to enforce its lien against the same land, the claimant, who has agreed not to pursue its rights within its own action, may prove its lien claim in the other claimant's action. This procedure hints of 'sheltering' one lien right under another which practice is not permitted by the Act.[149]

Should section 57 be removed from the Act on the grounds that the provisions are outdated and no longer relevant?

g) The Lien Form

i. Period of Credit

The Act includes a schedule of prescribed forms, the first of which is to be utilized in the registration of a lien claim. The Act requires that the prescribed claim for lien form must include "…where credit has been given by the lien claimant for payment for his work or services or materials, the date of expiry of the period of credit"[150].

It seems that this requirement may be a vestige of the past, no longer relevant to consideration of the validity, enforceability or proper time for registration of any lien. It is proposed that section 38(1)(f) and prescribed lien forms be revised to delete all reference to expiry of a credit period.

ii. Number of Claimants per Lien Form

Section 39 of the Act provides procedural guidance where a lien claim includes multiple parcels of land or multiple lien claimants:

[148] *supra*, note 1, s 57(2).
[149] *South Westman Regional Health Authority Inc. v. Accurate Dorwin Co*., 2001 MBCA 127, 156 Man R (2d) 284, at 47.
[150] *supra*, note 1, s 38(1)(f).

What may be included in claim

39 A claim for lien may include claims against any number of parcels of land and any number of persons claiming liens upon the same land may unite in a claim for lien, but where more than one lien is included in one claim for lien, each lien shall be verified by affidavit as provided by subsection 38(2).

This provision could unnecessarily complicate lien vacation and enforcement proceedings. Often a construction project will involve multiple titles to land and, therefore, it is appropriate for lien claims to be registered on multiple parcels of land in a single form. However, there is no apparent advantage and many undesirable complications that could arise from allowing multiple separate claimants to be named in a single form of lien. For example, lien claimants do not share in each other's lien rights and each party is at liberty to independently withdraw or settle its lien claim. Each lien claimant must, in any event, pursue and enforce its own lien claim without regard to others and a combination of multiple claims in a single lien registration could complicate such proceedings unnecessarily.

If you have experienced challenges associated with multiple claimants named in a Claim for Lien form, the Commission is interested to hear about it. Are there benefits to allowing multiple claimants to be named in a Claim for Lien form?

h) Revise Heading for Section 45(2)

Headings for statutory sections should guide the reader and should not mislead. The heading in the Act for section 45(2), "*Notice of claim to holdback*" is an oversimplification of the purpose and effect of giving a written notice of claim for lien to an owner which is the Crown, a Crown agency or municipality where section 16 prevents liens from forming a charge on land.

Pursuant to section 27(7), such a duly delivered notice of claim for lien obliges the owner to retain, out of amounts payable to the contractor or sub-contractor under whom the lien is derived, an amount equal to the amount claimed in the notice. Holdback may be just a portion of the total sum attached.

It is proposed that the current heading for section 45(2) be replaced with an improved heading such as "*Written notice versus registration of lien claim"*.

i) Single Family Residence Exception

As a general rule, the Act directs that owners are required, on request, to provide a true copy of a certificate of substantial performance to potential lien claimants within ten days of the owner's

receipt of the certificate.[151] However, where an individual "orders work, services or materials for construction of a structure or for improving land owned and occupied by the individual or his or her spouse or common-law partner for single family residential purposes"[152] and where the contract price does not exceed $75,000[153], that individual is exempt from the above requirements. Under the Act, the definitions of both "common-law partner" and "registered common-law relationship" require the relationship to be registered under *The Vital Statistics Act*[154].

Such intrusive, personal details respecting the personal living arrangements of an individual 'owner' engaged in a construction project seem out of place in the Act.
It should also be noted that the Manitoba Act is the only lien legislation in Canada that includes such an exception for single family residences.

It is therefore proposed that the exception contemplated by section 59(3) be expanded to apply instead to 'the single family residence occupied by the individual' without regard to the ownership of the property.

ISSUES FOR DISCUSSION #32

Stakeholders are invited to comment on any and all matters considered in *14. Minor Lien Provision Updates* above. Please identify the issues you choose to address referring to clause 14 a) – i) and setting out each heading responded to.

[151] *supra* note 1, ss 59(1); the potential lien claimants entitled to a true copy of the certificate of substantial performance are limited to "…all persons doing work, providing services or supplying materials in the performance of the contract who have requested the owner, in writing by personal service with a return address, to give them a copy of the certificate".
[152] Ibid ss 59(3).
[153] Man Reg 127/89, s 3.
[154] RSM 1987, c. V60.

CHAPTER 5- INTERACTION OF TRUST AND LIEN PROVISIONS IN THE ACT FOLLOWING THE SUPREME COURT'S RECENT DECISION

1. Overview

Underpinning the statutory remedies provided by the Act for claimants seeking to be paid for work, services or materials provided to improve the value of an owner's land, is each claimant's specific contract or sub-contract. These contracts or sub-contracts set out terms for the claimant's proper performance and entitlement to be paid an agreed contract or sub-contract price. As the work progresses, contractually approved changes to the scope of the work can alter the total amount to which the claimant is ultimately entitled. The Act does not alter contract price, sub-contract prices or the total amount the owner must pay for construction of the project.

Trust provisions seek to keep the owner's fund for financing the project within the construction contract pyramid and flowing down the proper contractual payment chains. Lien provisions create a right for each potential lien claimant to register a claim for lien for the unpaid value of its completed work against the owner's title to the land (in most cases) and against the holdback account that an owner must deduct and maintain. Under a complex set of provisions in the Act, a lien claimant can ultimately force the sale of the owner's land to recover its valid and enforceable claim from proceeds of the sale if necessary.[155]

A lien arises as a floating charge when a claimant's work commences and becomes a fixed charge at time of registration. Liens are often registered while the work is still progressing. The effect of lien registration on an active construction project is dramatic. Several sections of the Act *stay the hand of the paymaster*, prohibiting payments from continuing in the face of a registered lien.[156] Mortgage companies refuse to make further advances to the owner. The owner cannot pay the contractor. The normal flow of payments down all contract payment chains is suspended until the lien registration is removed from the land.

Section 55(2) of the Act provides the safety valve to relieve the disruption caused by registration of a lien. Upon application to the Court of Queen's Bench, money or security can be posted in court to stand in place of the land. The Court then issues an order *vacating* registration of the lien so that normal payment processes can resume.

It is possible to file and have an application under section 55(2) of the Act heard within one or two weeks of a lien being registered, provided the matter is uncontested and the facts are straight forward. From 1981, when the present process was introduced, until 2012, the section operated quite efficiently. In 2014, a lien vacation case arose in which novel facts and legal arguments

[155] *supra* note 1, ss 68-71.
[156] Ibid, *ss* 25(1), (2) & (3), ss 27(1)&(3), s 30 & s31.

exposed the Legislature's failure to provide for the interaction of trust and lien provisions housed in the same remedial statute.

The remainder of this Chapter includes a summary of the Supreme Court of Canada's decision in *Stuart Olson Dominion Construction Ltd. v. Structal Heavy Steel*[157] (SOD v. Structal), a discussion of the issues raised by the case and proposed solutions which are being presented for Stakeholder consideration and feedback.

2. Case Summary: *Stuart Olson Dominion Construction Ltd. v. Structal Heavy Steel*

Prior to substantial performance being achieved, disputes arose on the Winnipeg stadium project between the general contractor, Stuart Olson Dominion Construction Ltd. ("SOD") and its heavy steel sub-contractor, Structal Heavy Steel ("Structal"). In September 2012, Structal registered a claim for lien in an amount exceeding $15 million. The Contractor promptly applied to the Court under section 55(2) of the Act for an order vacating the lien and posted a lien bond for the full amount of the lien claim. By order of the Court, the lien registration against the stadium owner's land was then vacated.

A progress payment was certified which included approximately $3.5 million for work performed by Structal. SOD received the certified amount but refused to pay it to Structal because the value was included in Structal's lien for which security had been posted. Structal complained to the owner that SOD was breaching its trust obligations and the owner withheld further payments otherwise due to SOD equal to the amount certified on Structal's account pending receipt of a court order directing how it should proceed in the circumstances. SOD applied to the Court for the requested directions.

A Queen's Bench judge determined that there was no express requirement in the Act calling for double security for any claim and that it would be commercially unreasonable and contrary to the intention of the Act to do so.[158] On the basis of that determination, the owner paid the amount otherwise due to SOD which used the funds to pay other beneficiaries of the trust including itself. Structal paid all of its sub-trades and suppliers from its own funds, and appealed the Queen's Bench decision in the Manitoba Court of Appeal. The lower court's decision was overturned.

SOD then sought and obtained leave to appeal the Manitoba Court of Appeal decision to the Supreme Court of Canada (SCC). The pivotal issue argued before that Court was whether, by posting a lien bond in court with the intention of vacating a registered builder's lien, the contractor had satisfied its trust obligations to Structal.[159]

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[157] *Structal*, *supra* note 45.
[158] *Stuart Olson Dominion Construction Ltd. v. Structal Heavy Steel*, 2013 MBQB 48, 289 Man R (2d) 194, para. 18.
[159] Ibid, para 2.

Rothstein, J. wrote the unanimous decision for the Court observing:

> ...in consolidating these two acts, (*The Builders and Workers Act*, R.S. 1970, c. B90, and *The Mechanics' Liens Act,* R.S.M. 1970, c. M80), the legislature did not expressly delineate how the lien and trust provisions were to interact in situations such as this case, where both remedies are pursued at the same time by a contractor or subcontractor. [emphasis added][160]

Concurring with the result in the Manitoba Court of Appeal, the SCC pointed out that posting 'security' is not the same as making a 'payment'.[161] If SOD had posted the trust funds certified for payment on Structal's account instead of posting a lien bond for the certified portion of the lien claim, SOD would have preserved and protected specific trust funds in compliance with its trust obligations under the Act.

The impact of the *SOD v Structal* decision on the established operation of the section 55(2) of the Act cannot be overstated. The challenge is how to restore section 55(2) and provide a commercially reasonable mechanism for vacating and securing liens registered against land. To this end the Commission surmises that legislative clarification of the interaction between the trust and lien principles contained in the Act would be beneficial to all of the players involved.

3. Delineating Interaction between Trust and Lien Provisions on a Section 55(2) Application

The Commission is approaching the issue set out by Justice Rothstein in *SOD v Structal* with the following specific reform objectives in mind:

1) Seeking a solution which minimizes disruption of express provisions that conform to the purpose of the Act.
2) Seeking to maintain effective practices which have developed within the existing trust and lien schemes of the Act.
3) Seeking to minimize the negative impact of lien registration and vacation proceedings on the rights of other beneficiaries of the trust.
4) Seeking to accelerate final disposition of the rights of the holder of a vacated lien under section 55(2) in order to facilitate a timely final accounting for the project.

There is not a single amendment that could fill the 'gap' identified by the SCC in the *SOD v. Structal* case. Instead a *'set' of amendments* ought to be considered. Each reform proposed in the set is described in point form below. Discussion follows each point with invitations for Stakeholder comments.

[160] *Structal, supra* note 45, para 33.
[161] *Ibid.* para 43.

4. Proposed Amendments to Trust Provisions

a) Liens offer the only form of security provided

Issue: What statutory right or rights is a claimant given to obtain security for its unproven lien or trust claim prior to judgment?

Discussion:
In Manitoba, a claimant may obtain security for payment of a debt in advance of obtaining a garnishment prior to judgment pursuant to Queen's Bench Rule 46.14. Section 6(2) of *The Builders' Liens Act*, however, expressly prohibits any garnishment of funds impressed with a statutory trust. Therefore, this avenue of obtaining prejudgment security against trust funds was clearly closed to Structal by section 6(2) of the Act.

Lien rights duly exercised under the Act do give rise to security prior to judgment. In the case of liens registered against land, the land is charged and stands as security for the amount of the lien claim. If an application is then made under section 55(2) of the Act, cash or other forms of security may be posted to 'stand in place of the land'.

Section 16 provides that where the Crown, a Crown agency, or a municipality is the owner of the land at issue, the lien constitutes a charge on the holdback and does not attach to the interest in the land. Section 27(7) states:

> **Charge on further amounts payable by Crown or municipality**
> 27(7) Where a lien does not attach to land by reason of section 16, and a person claiming the lien gives the owner [...] notice in writing of the lien, the owner […] so notified shall retain out of amounts payable to the contractor or sub-contractor under whom the lien is derived an amount equal to the amount claimed in the notice.

Section 27(7) therefore provides a special form of protection or 'security' exclusively for lien claimants who *cannot* register a lien against land and who do not qualify for the posting of security to stand in place of the land under section 55(2) and section 56 of the Act.

In *SOD v. Structal*, one may assume that Structal did not originally want double 'security' for the certified amount. When it approached the owner complaining that SOD was violating trust provisions by refusing to pay Structal, it no doubt simply wanted to be paid the $3.5 million amount certified as an amount then owing on its account. If there had not been a right to set-off and counterclaim asserted against these funds, the lien security could have been reduced, and payment could have flowed.

The owner, however, responded to Structal's payment demands and SOD's assertion of its right to set-off/counterclaim against trust funds by withholding from funds otherwise due to SOD an amount equal to the sum certified on Structal's account pending receipt of directions from the court.

Despite the fact that Structal's $15 million claim for lien had been registered against title to lands owned by the corporate owner of the stadium and the lien had already been fully secured when registration of Structal's lien was vacated, the corporate stadium owner proceeded to stay its own hand suspending further payments otherwise due to SOD as if the case fell within section 16 and section 27(7) of the Act. This misapplication of the Act may have occurred because Crown entities most familiar with section 16 and section 27(7) procedures were actively involved in oversight of the project.

The proposed reform is intended to expressly dispose of any confusion that might otherwise linger from the facts and irregular conduct of the owner reported in the *SOD v Structal* decision.

Proposal for Consideration:

No claimant seeking payment of money including payment of trust money is entitled to security for its claim except through due exercise of any lien rights it may have under the Act and under section 27(7) where that subsection applies.

ISSUE FOR DISCUSSION #33

Provide any comments or specific concerns you may have about the above proposal for reform which is intended to help delineate the interaction of trust and lien provisions in the Act.

b) Obligations to Account

Issue: Should express provisions in the Act require an accounting with full and timely disclosure of all payments claimed, made and received on account of the contract price including claims resolved pursuant to a section 55(2) application?

Discussion:
The Act contemplates trustees overstepping the bounds of privity to directly pay others involved in a construction project. Any such direct payment should be duly accounted for against project trust funds to prevent the possibility of double payment.

Further, there is no direction in section 55(2) limiting who may be an applicant to vacate a lien under that section. Normally contracts put the onus on the contractor to attend to disposition of liens arising under it. If a lien is registered by the contractor, the owner is left to make the application instead. Strangers to the trust (such as a bonding company, lender, receiver, etc.) might make an application and the circumstances might allow such volunteers to make some recovery from project trust funds.

The objective here is to focus attention on the end goal of collecting payment due under a contract or sub-contract for part or all of the price agreed upon with introduction of express obligations to account for all amounts paid on the claimant's account for work duly completed from any non-trust fund sources. All payments made and received should be duly accounted for as against the project trust fund.

Legal costs incurred in the exercise of statutory remedies are not normally included in contract or sub-contract prices and, therefore, have not been considered for inclusion in the accounting of trust funds.

Proposal for Consideration:

(i) *To the extent that a claimant receives payment on its account from any source, the claimant shall promptly disclose full particulars to the owner for accounting purposes and adjustments shall be made to avoid duplicate payment for the value of its completed work.*

(ii) *An applicant under section 55(2) who posts the required security to obtain an order vacating one or more registered liens shall, upon final disposition of the vacated lien claims, report and account to the owner for determination of the applicant payer's possible entitlement to recover some or all of the amounts it has paid to satisfy such lien claims from the project trust fund under terms of the trust.*

ISSUE FOR DISCUSSION #34

Provide any comments or specific concerns you may have about the above proposal for reform which is intended to require an accounting with full and timely disclosure of payments made and received, including claims pursuant to a section 55(2) application.

5. Amendments to Lien Provisions

a) Lien for holdback and non-holdback amounts:

Issue: Could existing provisions in the Act respecting the charge a lien forms on holdback and the existing limitation in section 56(2) be used to enhance dispositions made under section 55(2) as contemplated in clauses b) and d) below?

Discussion:

In Chapter 4 of this Consultation Paper, the Commission has considered bringing section 13 and section 26 provisions together to clarify that liens created by the Act not only attach to land but also form a charge on the holdback account.

Although it has been a common practice to pay trust monies, including holdback, into court to stand as security in place of the land, section 56(2) has, since the Act was introduced, expressly provided that "money paid into court or security given under subsection 55(2) does not reduce the amount required to be retained by the owner under section 24" [emphasis added]. In other words, the legislature never intended or permitted holdback money to be paid into court to stand as security for vacation of liens registered against land.

Proposal for Consideration:

Appropriate language may include the following:

> *In its notice of claim for lien, the claimant shall disclose the value, if any, included in the claim for holdback accrued on its account, and shall also disclose the value included in the claim that is for non-holdback amounts.*
>
> *Upon registration of a lien against an owner's estate in land, the floating charge for the value of completed work claimed crystallizes and becomes a fixed charge attaching:*
> *i) the holdback fund to the extent that the registered lien value includes any amount for holdback, and*
> *ii) title to the owner's land to the extent that the registered lien value is for non-holdback amounts.*

ISSUE FOR DISCUSSION #35

Do you see any difficulties arising from reforms calling for identification of holdback versus non-holdback portions of each claim for lien?

b) Section 55(2) application to vacate lien from title to land:

Issue: Would section 55(2) be enhanced by fixing the amount of security required to be posted at the non-holdback value of registered liens being vacated, and by expanding the forms of security allowed?

Discussion:
Section 55(2) has always contemplated just one thing – vacation or removal of liens registered *against land*. There is no provision in the Act allowing discharge or removal of a lien to the extent that it forms a fixed charge on holdback.

Section 27 (4), discussed in clause d) below, sets out the time and conditions under which a registered lien claimant may exchange a discharge of its lien on holdback with the owner for release of holdback due to that claimant.

Current measures included in section 55(2) for determining the amount of security to be posted refer to:

- an amount equal to the holdback required under this Act as it applies to a particular contract and
- any money payable with respect to that contract but not yet paid.

The section then goes on to state that the security shall not exceed the total amount of the liens then registered. The urgency facing applicants seeking a court order to vacate registered liens has discouraged taking the time required to contest and obtain judicial interpretation of these provisions. Uncertainties have therefore never been resolved. The suggestion in light of other changes contemplated in this 'set' of proposed reforms, is to instead simply call for posting of security for the full non-holdback value of the lien(s) registered.

The form of security which is acceptable to lien claimants has been debated from time to time. Lien bonds in a form approved for the purpose and issued by a surety company which meets standards to be set out in Regulations should provide appropriate assurance for any concerns. Irrevocable letters of credit can also be limited to a prescribed form issued by a limited class of acceptable financial institutions to address any concerns about the reliability of such instruments.

Ontario recently amended its Act to permit letters of credit to be posted as security for vacated liens.[162]

[162] *Construction Act*, *supra* note 57 at s 44(5.1).

Proposal for Consideration:

Appropriate language may include the following:

> *Upon an application being made under section 55(2) of the Act to vacate a lien registered against land, the applicant may post security for the non-holdback value of the lien claim to obtain an order vacating the registration from title to the land.*
>
> *Upon security being posted to stand as security in place of the land, an order may issue to vacate the lien from title to the land. Security may be posted under section 55(2) of the Act in the form of cash, lien bond and/or irrevocable letter of credit, the latter two being in forms prescribed and provided by third parties as permitted by Regulation.*

ISSUE FOR DISCUSSION #36

Provide any comments or suggestions you may have in respect of the above reforms proposed which are intended to clarify and refine operation of section 55(2).

c) No interference with flow of trust funds:

Issue: Does integration of trust and lien provisions in the Act call for improved protection for trust claimants who are not involved in an application for vacation of liens?

Discussion:

The *SOD v. Structal* case involved trust provisions colliding with lien provisions in a manner which seriously impaired rather than facilitated timely return to normal payment processes on an incomplete construction project. Section 55(2) was introduced to 'free the hand of the paymaster' and allow projects to proceed while providing suitable protection for a registered lien claim. This section currently provides:

> **Vacating lien on payment into court, etc.**
> 55(2) Upon application, a judge may order security or payment into court in an amount equal to the holdback required under this Act as it applies to a particular contract and any additional money payable with respect to that contract but not yet paid but not exceeding the total amount of the claims for liens then registered against a parcel of land and may then order that the registration of those liens be vacated.

For purposes of this Chapter, considerable attention has been paid to reconciling the potential for conflict between trust and lien rights under the current Act. The solution presented in the set of revisions proposed would newly prohibit drawing 'payable but not yet paid' *trust funds* into use as security upon vacation of a registered claim for lien. Use of trust funds to secure one or more registered claims for lien can result in extreme prejudice to other beneficiaries of the trust.

Lien bonds and irrevocable letters of credit represent familiar, available options for using third party resources to stand as security. Cash, if used, should either be that of the applicant or trust funds which can be proven to be subject to only the trust claim of the lien claimant.

Proposal for Consideration:

Cash posted to stand as security on a section 55(2) application shall not be holdback money retained or money otherwise impressed with a trust for the benefit of persons other than the lien claimant.

ISSUE FOR DISCUSSION #37

Provide any comments or suggestions you may have in respect of the above reforms proposed which are intended to improve operation of section 55(2).

d) Reduce Time for Enforcement of Vacated Liens:

Issue: Would prompt resolution of vacated lien claims enhance administration of lien and trust provisions in the Act?

Discussion:
A lien claimant whose registered lien against land has been vacated under section 55(2) of the Act currently has two years from the date of lien registration to sue and enforce its claim against the security posted in court.[163]

While the current period for suing to enforce a lien in Ontario is forty-five days, this will soon increase to ninety days upon proclamation of the amended act in that province.[164]

It is suggested that a period of two years is far too long for such unresolved claims to languish. Reducing the time period to sixty days from the date the security is posted as proposed is intended to mesh with introduction of an express Obligation to Account as proposed at pages 69 and 70

[163] *supra* note 1, ss 49(2) & ss 51(b).
[164] *The Construction Act*, supra note 57 at s 36(2). Note that Ontario's timeline for the expiration of a preserved lien runs from the last day on which the lien *could* have been preserved under the Act- not the day that the lien was actually filed. In contrast, in Manitoba, a lien expires two years after registration unless an action is commenced.

above. Unless there is prompt resolution of the vacated lien claim against security posted, the final accounting for a project could be long delayed or rendered impossible to complete.

Proposal for Consideration:

> *After security has been posted to stand in the place of land on an application under section 55(2) of the Act, the holder of a vacated lien shall have 60 days from the date security is posted to commence an action to prove the validity and enforceability of its lien or its lien shall expire and the security shall be returned to the applicant who posted it in court.*

ISSUE FOR DISCUSSION #38

Should the proposed time limit of two years from the date security is posted for commencement of an action to enforce a claim for lien against security posted to stand in the place of land be revised? If so, do you believe that the appropriate limit is 60 days? If not, what is an appropriate limit?

e) Satisfaction of fixed lien charge on holdback:

Issue: Would integration of lien and trust provisions in the Act be enhanced by sustaining lien charges on holdback until payout following substantial performance?

Discussion:
Section 27(4) of the Act provides a method for satisfying and obtaining discharge of any registered lien and fixed charge on holdback:

> **Payment of holdback where liens are registered**
>
> 27(4) Where, on the expiration of the 40 days mentioned in subsection 24(1) or (2), as the case may be, there are liens registered against the land to which a contract relates, the holdback retained under this Act in respect of the contract may be validly paid for the purpose of obtaining discharges of all those registered liens unless before the payment of the holdback an action has been commenced under this Act to enforce one or more of those liens.

A claimant might choose to forego the proposed opportunity to identify the holdback portion of its lien claim; however it may be that better outcomes would result from disclosing the amount of holdback claimed at time of registration to obtain and retain the resulting fixed charge until it is time for the owner to release holdback. The availability of specific rights prohibiting set off and counterclaim under section 27(6) could prove to be an important consideration in this regard.

Proposal for Consideration:

> *The portion of a claim for lien which has been registered to thereby become a fixed charge on holdback cannot be vacated under section 55(2) but instead shall continue to stand as a fixed charge on holdback retained until the owner is at liberty to release holdback under section 27 (4) of the Act. The owner may then release the appropriate amount of holdback to the lien claimant in order to obtain its discharge of lien.*

ISSUE FOR DISCUSSION #39

Provide comments on the proposed method for resolving the holdback portion of a registered lien claim for lien.

ISSUE FOR DISCUSSION #40

How else might *The Builders' Liens Act* be amended in response to the Supreme Court of Canada's decision in *Stuart Olson Dominion Construction Ltd. v. Structal Heavy Steel* to ensure the Act fulfills its stated purpose and is effective for Manitoba's construction industry?

CHAPTER 6 – SIMPLIFY COURT PROCEDURES

1. Background

When the trust and lien remedial legislative schemes for the construction industry were carried forward in a single statute in 1981, both the County Court and the Court of Queen's Bench operated in Manitoba. Lien enforcement continued to be within the sole jurisdiction of the County Court. Enforcement of trusts continued within the equitable jurisdiction of the Court of Queen's Bench. Prior to 1981, lien enforcement under *The Mechanics' Liens Act* called for mini class action suits to address the rights of multiple unsatisfied lien claimants who were allowed to join, shelter under and participate in various ways in actions commenced by others seeking an order for sale of an owner's improved land.[165] Vestiges of these antiquated court procedures were carried forward in the Act and have not been updated to deal with changed circumstances.

The jurisdiction of the County Court was absorbed into that of the Court of Queen's Bench in 1984.[166] The Small Claims Court Division of the Court of Queen's Bench continued to provide an inexpensive venue for self-represented claimants to obtain money judgments of low value. Today the maximum judgment available in Small Claims Court is $10,000, but a recommendation has been made by the MLRC to increase the limit.[167]

The much improved lien vacation proceedings, included as section 55(2) in the Act in 1981, have dramatically changed the practice for enforcement of builders' liens. We are not aware of any case proceeding to a judgment resulting in an order requiring the sale of land under the Act in the past 30 years. Instead registered liens are typically vacated upon security being posted under section 55(2) and one or more affected lien claimants then proceed with an action to enforce their liens against the security that stands in place of the land.

The Commission is aware that players in the construction industry in Manitoba are seeking a quicker resolution to construction disputes. While the issue will be considered further in the next chapter on Prompt Payment, in this chapter the Commission explores options for updating and reforming methods by which trust and lien claimants can access justice for resolution of claims and disputes arising under the Act.

[165] *supra* note 26, s 35.
[166] See *An Act to Amend The Queen's Bench Act and to repeal The County Courts Act, The Surrogate Courts Act and The County Court Judges Courts Act and to amend The Municipal Boundaries Act,* RSM 1982-83-84, c 82.
[167] See Manitoba Law Reform Commission, "Improving the Small Claims System in Manitoba" **(**Report #134) (Winnipeg: Manitoba Law Reform Commission, 2017).

2. Options for Reform

a) Court of Queen's Bench Rules

The remedial schemes in the Act are no more challenging to interpret and enforce than other statutory provisions and common law remedies that are being administered according to comprehensive litigation procedures set out in the Court of Queen's Bench Rules.

The archaic lien enforcement procedures carried forward from the former County Court system, largely in sections 61-67 of the Act,[168] set out procedural directives that run parallel, and sometimes contrary, to the generally applicable Court of Queen's Bench Rules. Additional procedural provisions, some of which have been flagged earlier in this Report, are also distributed through the Act.[169]

At issue is whether it remains necessary or beneficial for the Act to set out rules of procedure separate and apart from the codified rules contained in the *Queen's Bench Rules* which apply generally to all civil actions. It can be argued that a rationale no longer exists for separate rules governing: provision of notice of trial to other lienholders;[170] allowing any number of lienholders to join in an action;[171] requiring a judge to direct any discontinuance of an action commenced;[172] setting out default judgment provisions specific to a lien enforcement proceedings;[173] providing an 'opportunity' for lienholders who have not commenced their own lien enforcement action to prove their claim within the action commenced;[174] providing for appealable directions for management of the proceeding;[175] setting out a lien proceeding-specific rule for consolidation of actions;[176] providing for a judge to direct a party to have 'carriage of the action';[177] or providing lien enforcement proceeding specific rules respecting third party proceedings.[178]

The Act provides special powers to Queen's Bench judges which can be of assistance and need not be disturbed. For example section 24(4), section 25(8) and section 46(3) empower a judge to issue certificates of substantial performance upon an application being made; and section 58(6) authorizes a judge to order production of documents from a wide group of persons as required to enforce a lien in an action commenced under the Act.

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[168] These sections of the Act establish the procedural steps for and rules governing a civil action to enforce a lien in the Court of Queen's Bench.
[169] For example, ss. 57(4) states that "notwithstanding that a person has given or extended time for payment of any claim for which he has a lien, he may, where an action is commenced by another person to enforce a lien against the same land, prove and obtain payment of his claim in the action as if no time had been given for payment of the claim".
[170] *supra*, note 1, s 63(b).
[171] Ibid, s 61(2).
[172] Ibid, s 61(3).
[173] Ibid, s 62.
[174] Ibid, s 64.
[175] Ibid, s 65(1)&(2).
[176] Ibid, s 67(1).
[177] Ibid, s 67(2).
[178] Ibid, s 67(4).

There are also special powers provided in the Act which should be preserved such as section 69(1) and (2), which authorize appointment of a Receiver or a Trustee to gather revenue from property at issue and assist in liquidation in aid of an enforcement proceeding under the Act. Under section 78, a judge is also expressly empowered to refer aspects of a lien action to a Master of the Court to assist in resolving issues, take accounts, etc.

ISSUE FOR DISCUSSION #41

Advise if, in your view, any of the proposed revisions to procedural aspects of the Act discussed above bear further comment or consideration.

b) Increased Role for Small Claims Court

At present a lien claimant with a low value lien is faced with a difficult choice: sue to enforce the lien in the Court of Queen's Bench as the Act requires, or abandon lien rights to sue only on the grounds of 'debt' seeking a quick money judgment in Small Claims Court. Small Claims hearing officers do not have jurisdiction to determine lien or trust rights.[179]

The maximum judgment currently available in Small Claims Court is $10,000, but by the time this review is completed, the limit may have been increased.

One possible option for reform is to recommend co-ordination of changes to the Act and procedures in the Court Rules to allow for the Small Claims Division of the Court of Queen's Bench to determine liability for the debt/monetary portion of claims arising under the Act and to have the associated right to enforce a lien against security, including land, and any breach of trust allegations determined in the higher Court of Queen's Bench.

Claimants can represent themselves in Small Claims Court making this process inexpensive in comparison to an action in the Court of Queen's Bench. Even where legal counsel is used, there is no pretrial discovery and hearings. Small Claims are currently being heard two to four months after the filing a statement of claim in Small Claims Court. In the event that a large volume of small construction related claims was to be directed to Small Claims Court as part of a plan for more effective and timely disposition, the associated recommendations could be contingent upon the appointment of more hearing officers.

[179] *The Court of Queen's Bench Small Claims Practices Act*, CCSM c C285, s 3(4)(a).

No recommendation or option for reform arises from the discussion above. It is, however, intended to set the stage for further discussion of related matters in Chapter 7 of this Consultation Paper.

ISSUE FOR DISCUSSION #42

In your opinion, could expansion of the role for Small Claims Court, as outlined above, improve the mechanisms for enforcement of claims for builders' liens and trusts in Manitoba?

CHAPTER 7 – PROMPT PAYMENT REGIME ALIGNED WITH TRUST PROVISIONS

1. Free-Standing Prompt Payment Legislation

The movement promoting government intervention to pass new laws throughout North America requiring owners, contractors and sub-contractors to more promptly pay amounts due to participants in the construction contract pyramid has often sought free-standing legislation rather than undertaking the more daunting task of incorporating such provisions in existing trust and lien statutes.

As was summarized succinctly by the authors of the Ontario Report:

> … in attempting to develop legislation that effectively encourages prompt payment, it is necessary to attempt to find the right balance between the legitimate interests of the stakeholders, being the payers and the payees, which is essential to the practical success of legislation and necessary to justify the infringement on freedom of contract that it will represent.[180]

The writers also provided a good summarization of the basic features of prompt payment legislation throughout the world:

- the right of a contractor or subcontractor to make claims for progress payments;
- an owner or a general contractor's obligation to evaluate a claim for payment within a reasonable period of time;
- the right to give written notice of a disputed claim for payment (and the reasons for the dispute);
- the imposition of penalties on late payments such as interest payments (set by statutes of contract);
- the right of a contractor or subcontractor to suspend performance for non-payment; and
- the prohibition of conditional payment provisions.[181]

2. Prompt Payment in Manitoba

In the first 6 chapters of this Consultation Paper, the Commission has undertaken the review of a long list of issues for possible reforms intended to modernize the current Act. The last major issue for consideration by Stakeholders is whether the goal of prompt payment in the construction industry can best be secured by free-standing legislation or an updated *Builders' Liens Act.*

The following special concepts and provisions are suggested to link a new prompt payment regime to updated and enhanced trust provisions in the Act:

[180] Ontario Report *supra* note 3 at 177.
[181] Ibid.

- Define **'schedule of values'** to mean a document to be included with each contractor's proper invoice setting out the values for its own forces work and the sub-contracted parts of the work, aggregating the total amount of the contract price claimed to facilitate evaluation of each application for payment.
- Contractor and sub-contractor '**proper invoices**' should include sufficient particulars to identify amounts claimed for each payee/beneficiary in privity with the payer and approved in the resulting payment certificate as each payment flows down the payment chain.
- Define **'payment certifier'** to mean the owner and/or the owner's delegate appointed to evaluate payment applications and the completeness of the work in accordance with the contract and the owner/trustee's *Duty of good faith*.
- Particulars for the trustee ***Duty to account*** and **section 58 Rights to Information** should be developed to expressly require full and timely disclosure to all affected beneficiaries of payment applications submitted at each level of the contract pyramid, particulars of each payment certifier rejection and approval to allow invoice corrections and identification of proper amounts due to each named beneficiary to the end of each contract payment chain.
- Define **'prompt payment'** in accordance with the payment periods set out in the Act, and use this term in each description of the express *Duties* of each trustee.[i.e. ...shall promptly pay....]
- Consider whether breach by a trustee of the *Duty to promptly pay* should, upon an adjudicator's finding of *bad faith,* be subject to an order for payment of the affected beneficiary's **collection costs** reasonably incurred.

ISSUE FOR DISCUSSION #43

Would inclusion of new trust provision 'linkages' such as those suggested above, provide a logical and more substantive legal base, in your view, for a prompt payment regime within the Act than in free-standing legislation?

3. Components of a Prompt Payment Regime

The Ontario Report review provides a comprehensive overview of prompt payment regimes. The conclusions drawn by the writers of that report are a logical starting point for consideration of reforms to the Manitoba scheme. Below, we consider the different components of prompt payment considered in the Ontario Report and provide references for those who wish to review the full text of each recommendation in context.

4. Manitoba Consideration of Recommendations in the Ontario Report on Prompt Payment

The Ontario Report considered prompt payment legislative schemes of various jurisdictions and proposed a made-for-Ontario solution. Each Ontario recommendation summarized and discussed below needs to be considered in the Manitoba context having due regard to this province's unique statutory scheme and the unique challenges of Manitoba's construction industry. Stakeholders are encouraged to provide the Commission with their consideration and comments.

a) Application to the Public and Private Sector

In the Ontario Report, the writers recommended that the Ontario government legislate a prompt payment regime to be applicable to both public and private sectors which is to be implied into all construction contracts which do not contain equivalent terms. *(recommendation 47 of the Ontario Report* – page 192*)*

The Commission suggests that any prompt payment regime in Manitoba should apply to all construction projects/contracts which fall within the Act.

b) Entire Payment Chain

The Ontario Report recommended that a prompt payment regime should apply at every level in the construction contract pyramid, starting with the owner and contractor at the apex and continuing down each payment chain. *(recommendation 48 in the Ontario Report* – p. 194*)*

c) Actions Required Upon Non-Payment by Owner

The recommendation was made in the Ontario Report that the legislation should include a mechanism for contractors to notify sub-contractors of non-payment by owners providing reasonable particulars and undertaking to commence and continue proceedings to enforce payment so as to defer their payment obligations. *(recommendation 48 in the Ontario Report* – p. 194*)*

The Commission proposes that Manitoba's Act could be revised to require that the following actions may be required upon non-payment:

- proceedings in the face of non-payment by an owner could include guidance from the contractor in a plan of strategic lien registration, not only by the contractor, but also by sub-contractors if the owner's default is unlikely to otherwise be remedied; and
- deferral of contractor payment obligations could be expressly limited to a specified period in time; and/or Pay When/If Paid clauses in contracts could be prohibited in whole or in part by the Act.

d) Proper Invoice as Trigger for Time

Delivery of a proper invoice triggers time running for payment and if certification is provided for in the contract, certification is to follow. *(recommendation 49 of the Ontario Report – p. 196)*

Current and enhanced trust provisions discussed in Chapter 4 of this Consultation Paper provide for trust funds to flow upon certification – not as a contingent but as a basic requirement of enhanced trust provisions in the Act.

e) Times for Prompt Payment

Another issue for consideration is what is an appropriate time period for payment. The Ontario Report recommends and Ontario's *Construction Act* now provides the following time periods for payment under a construction contract:

- **28 days** from submission of a proper invoice as between owner and contractor; and
- **7 days** from receipt of payment as between contractor and sub-contractor, and so on down the contractual payment chain. *(recommendation 50 of the Ontario Report – p. 197)*

Determining the most appropriate time limits for payment requires consideration of a number of issues, specifically, the necessity of timely payment down the construction pyramid and the time necessary to conduct due diligence before making a payment.

f) Freedom to Contract

The conversation around prompt payment in the construction law context gives rise to consideration of competing purposes: the protection of parties through regulation versus protection of the freedom of parties to contract.

The writers of the Ontario Report recommend that parties be free to contract payment terms (including milestone payments), but if they fail to do so, monthly payments (i.e. every 28 days) should be implied. *(recommendation 51 of the Ontario Report – p. 197)*

g) Notice of Intention to Withhold Payment

Within 7 days of receipt of a proper invoice, a payer intending to pay less than the amount claimed, is to deliver a Notice of Intention to withhold payment setting out the amount to be withheld and providing adequate particulars as to why money is being held back. Money is only to be held back on the contract for which payment is claimed. Undisputed amounts claimed are to be paid. *(recommendation 52 of the Ontario Report – p. 199)*

h) Rights of Set-off/Counterclaim

Ontario's *Construction Lien Act* formerly permitted set-offs for debts unrelated to the project at issue. The Ontario Report recommended that payers be allowed to continue to set off but only for

'all outstanding debts, claims or damages' related to the subject contract. *(recommendation 53 of the Ontario Report – p. 199)* The Ontario *Construction Act* 2017 adopted this recommendation but added an exception allowing unrestricted set-offs where the contractor or sub-contractor is insolvent.[182]

To be consistent with earlier options for reform set out in this Consultation Paper, it is suggested that permitted progress payment 'withholding' by the payment certifier be based solely on a *bona fide* assessment of the value of completed work for which a payment claim has currently been made and is under review.

It is further proposed that the intention of any payer to assert a right of set off or counterclaim that relates to the adequacy of work performed for which payment has already been claimed and made shall first deliver a Notice of Intention to deduct a specified amount from future trust funds earned by the person(s) alleged to be responsible for a performance default and that person may either consent to such deduction in writing or may instead require the payer to submit its claim for adjudication to obtain a judgment or order before becoming entitled to appropriate trust funds to its own use by set off or counterclaim.

i) Interest Entitlement

The Ontario Report suggests that mandatory non-waivable interest be paid on late payments at the greater of the rate agreed in the contract and set for payment pre-judgment by the *Court of Justice Act. (recommendation* 54 *of the Ontario Report – p. 200)*

j) Right of Suspension

A right of suspension should arise after adjudication where the payer has neglected or refused to comply with the adjudicator's determination. *(recommendation* 55 *of the Ontario Report – p. 200)*

If the intention of this 'right' is to allow the payee to lawfully abandon performance of its contract, that may be an appropriate remedy for long unjustified non-payment. One wonders, though, if this remedy may have developed to provide a 'hammer' in jurisdictions where liens are not available. Consideration might be given in Manitoba to whether such a measure is necessary when payees typically have powerful lien rights available up to the time of substantial performance of the work.

k) Financial Disclosure Requirement

Financial disclosure requirements are limited in the Ontario Report to notice prior to bidding to sub-contractors in the event that the owner intends to pay on the basis of milestones achieved. *(recommendation* 56 *of the Ontario Report – p. 201)*

[182] *Construction Act*, supra note 57 at s 17(3).

The enhanced trust provisions and *Duty to Account* proposed for express inclusion in the Act would require full and fair disclosure by the owner of the sufficiency of the project trust fund, and full particulars by the contractor respecting contents of its progress payment claims, schedules of value, amounts certified and paid on each beneficiary's account, etc.

With respect to notice of milestone payment terms, it is unclear how a provision in the Act requiring certain conduct of the parties during the procurement phase of a project could be enforced, or what the consequences might be under the Act for non-compliance. Is there a better way to ensure that sub-contractors are given the proper information to guide their pricing and decision to bid milestone payment projects?

ISSUES FOR DISCUSSION #44

a) Do you favor introduction of a prompt payment regime in Manitoba?
b) If you are in favor of introduction of a prompt payment regime in Manitoba, what are the key elements you wish to see included in such a regime? Provide comments on the Ontario solutions you approve of and those you oppose. Respond, as you see fit, to the Commission's comments interspersed in the text above.
c) If you are of the view that a prompt payment regime for Manitoba would be more effective if introduced as a free-standing statute, explain why.

l) Adjudication of Prompt Payment Disputes

Based on a wide ranging review of prompt payment regimes in the United States and around the world, the Ontario Report concluded that, to be effective, a prompt payment regime requires a nimble adjudication process under which payment delays, refusals to pay and assertions of rights to set off for all manner of performance defaults including damages for delay could be addressed during the course of the work. The writers of the Ontario Report were particularly taken with the adjudication processes developed for this purpose in the United Kingdom where, it should be noted, builders' lien and trust regimes have never been part of the legal landscape.[183]

Another point of view to be considered is that enhancement of the trust provisions in Manitoba's Act, coupled with much improved transparency, the curbing of beneficiary status and automatic rights of set-off and counterclaim for trustees, combined with the express trustee *Duty to promptly pay*, might be sufficient.

[183] Wallace, I.N. Duncan, *Hudson's Building and Engineering Contracts*, loose-leaf, 11th ed (London: Sweet & Maxwell, 1995), ch 11.063 at 1239.

ISSUE FOR DISCUSSION #45

In your view would introduction of a prompt payment regime benefit from or require a dedicated adjudication process to be effective?

Ontario's Proposed Adjudication System

The Ontario Report contemplated introduction of an adjudication system characterized by the following:

- Access to 'a targeted interim binding dispute resolution method' as of right for all parties to Ontario construction contracts and sub-contracts (*Recommendations 57 and 60*);
- Parties be free to contract respecting prompt payment terms and adjudication but terms agreed which are inconsistent with the Ontario Act would, by default, be overtaken by the regime set out in regulations to the Act (*Recommendation 58*);
- Back-to-back adjudications should be permitted where the contractor is involved(*Recommendation 61*);
- In order for adjudications to be swift, disputes are to be addressed one at a time unless the parties otherwise consent (*Recommendation 62*);
- The Ontario government select the 'first tranche of eminently qualified individuals' based in specified centres to act as adjudicators until a system of training and qualification can be implemented (*Recommendation 63*);
- Adjudicators be selected according to criteria listed – including a minimum of 7 years of related work experience and membership in good standing in a self-governing professional body such as engineers, architects, accountants, lawyers, or quantity surveyors (*Recommendation 64*);
- Creation of an Adjudicator Nominating Authority together with institution of a process patterned upon arbitrator appointments (*Recommendations 65-69*);
- Parties be entitled to refer a dispute to adjudication that flows from a proper invoice under a construction contract or sub-contract including:
    - Valuation of work, services, materials and equipment supplied;
    - Other monetary claims per contract including change orders and proposed change orders;
    - A claim in relation to any security held by a party under the construction contract;
    - Set offs and deductions (i.e. for deficiencies) against amounts due under a proper invoice as set out in the Notice of Intention to withhold or otherwise; and
    - Delay issues as they relate to claims for payment. (*Recommendation 70*);

- Dispute values under $25,000 may be referred by the parties to adjudication or to small claims court (*Recommendation 71*); and
- Parties may agree to the procedures for the adjudication process failing which default procedures set out in regulations under the act will apply (*Recommendation 72*);
- Proposed fee and cost arrangements are set out (*Recommendations 73-75*);
- It is recommended by the Ontario Expert's Report that the decision of an adjudicator should be 'binding on the parties' and they should comply with the decision until either:
  - The dispute is finally determined by legal proceedings (including lien proceedings) or arbitration (if provided for in the contract or the parties agree to arbitrate)*;* or
  - The dispute is finally determined by the parties agreeing to be finally bound by the decision of the adjudicator (*Recommendation 76*);
- Adjudication decisions be enforced in the process available to domestic arbitration awards. (*Recommendation 77*); and
- Parties should maintain and pursue lien rights as they see fit.(*Recommendation 78*)

Royal Assent has now been granted on recent amendments to Ontario's Act which implement the adjudication scheme proposed in the Ontario Report and will come into force upon proclamation.

Discussion of Adjudication Options in Manitoba

Ontario and Manitoba construction litigation volume and costs are not similar. As discussed in Chapter 6, the Manitoba Courts are, by comparison, utilized for construction disputes on a limited basis. It is an option that, rather than follow Ontario's path involving creation of an entirely new adjudication system designed to grant interim decisions involving prompt payment disputes, access to and use of existing Manitoba court resources be maximized instead. Recourse to Small Claims Court for findings of liability up to $10,000 has been discussed. If a prompt payment regime is introduced by the Legislature, associated recommendations could also be made for dedication and appointment of well qualified Masters to absorb the brunt of any new volume of litigation cases resulting. Unless and until the volume of such cases expands, it is difficult to imagine that additional resources will be provided on the basis of a mere expectation that increased demand for judicial services will arise.

ISSUE FOR DISCUSSION #46

a) In the event that a prompt payment regime is introduced in Manitoba, are you of the view that an adjudication process will be required to enforce obligations imposed by such a regime?
b) If your answer to a) above is 'yes', do you favor creation of a new and separate adjudication system such as Ontario has enacted? If so, why? If not, why not?
c) Do you think that Manitoba courts can and will provide adequate recourse for enforcement of disputes arising out of a prompt payment regime if one is introduced in Manitoba?

GLOSSARY OF TERMS

Counterclaim: a claim presented by a defendant in opposition to or for deduction from the claim of the plaintiff. If established, such will defeat or diminish the plaintiff's claim.

Fiduciary: A person who has rights and powers which (s)he is bound to exercise for the benefit of another with whom (s)he stands in a fiduciary relationship. (S)he is not allowed to derive any profit or advantage from the relation between them, except with the knowledge and consent of the other person. Examples of fiduciary relationships include: solicitor and client, principal and agent.

Floating Charge: a continuing charge on specified assets which allows their owner to deal freely with the property in the usual course of business until the security holder intervenes to crystallize and enforce the charge.

***In Personam*:** designates equitable proceedings or actions instituted seeking judgment against an individual in his/her personal capacity.

***In Rem*:** designates equitable proceedings or actions instituted to recover real or personal property or one brought to enforce a right to possess a *thing* itself.

Payee: one to whom money is paid or is to be paid.

Payer: one who pays, or who is to make a payment.

Privity of contract: that legal relationship or connection which exists between parties to the same contract.

Set-off: the equitable right to cancel or offset mutual debts or cross demands.

Vacate: the process under section 55 of the Act whereby a lien registered against land is removed from title pursuant to an order of the Court of Queen's Bench.