

LAW REFORM COMMISSION OF BRITISH COLUMBIA

**REPORT ON
MINOR REPORT ON PRIORITY OF
BUILDERS LIENS UNDER BILL 52 (LRC 114)**

LRC 114

OCTOBER 1990

October 23, 1990

Dear Mr. Attorney:

**Re: Priority of Builders Liens under Bill 52
Minor Report (LRC 114)**

Late in the most recent session of the Provincial Legislature you introduced Bill 52, the *Builders Lien Act*, for exposure purposes. Reform of the Province's builders lien legislation is a topic which has a long history with the Law Reform Commission, and its members are pleased to see the extent to which the Commission's past work is reflected in the Bill. While the most immediate stimulus for the Bill was the Report of the Select Standing Committee on Labour, Justice and Intergovernmental Relations, the Committee, in turn, drew on a Report submitted by the Commission over 18 years ago recommending major conceptual and structural changes to the Act along the lines set out in the Bill.

One aspect of the *Builders Lien Act* was also the subject of a much more recent Law Reform Commission Report. In 1986 the Commission submitted its *Report on Mortgages of Land: The Priority of Further Advances*. A copy of that Report is enclosed for convenient reference. The Report examines the priority which a mortgage lender has with respect to advances of money which are made after an intervening interest in the mortgaged property has arisen. The intervening interest may be a judgment, a builders lien, or another mortgage. The rules which govern priority competitions between these interests and the mortgage lender are to be found in section 24 of the *Property Law Act* and section 6 of the current *Builders Lien Act*. The general policy of the law, as reflected in those provisions, is to give the intervening interest priority over the mortgage.

The Law Reform Commission's research identified two areas in which the application of this policy was unsatisfactory. With respect to those areas it was recommended that a mortgage lender should have priority for all advances, whenever made, over intervening interests. One of the areas identified by the Commission was where advances are made *bona fide* by the lender under a "construction mortgage" for the purposes of completing an improvement on land. The justification for this recommendation arises out of the unique character of construction financing and is described in Chapter IV of the Commission's 1986 Report.

In Bill 52, the priority of the secured lender is dealt with in section 31. Subsections (1) and (2) carry forward the policy of the current Act which subordinates the interest of the construction lender with respect to advances made after a lien has been filed. An important exception, however, is created by subsection 31(4). It provides:

31. (4) Where one or more liens have been filed in relation to an improvement, a mortgagee may apply to the court for an order that, notwithstanding subsection (2), a further advance under the mortgage have priority over the liens, and if the court is satisfied that
 - (a) the advance is intended for the bona fide purpose of completing the improvement, and
 - (b) the advance will result in an increased value of the land and the improvement at least equal to the amount of the proposed advance,

the court shall make the order.

This subsection is based directly on a recommendation made by the Select Standing Committee.

Section 31(4) reflects essentially the same concerns which moved the Law Reform Commission to

make its recommendation respecting the priority of construction mortgages and, I believe, there is little or no difference between the Commission and the Committee as to the basic principle involved. Where the recommendations of the two bodies diverge is on the way in which the goal is to be realized. The Commission acknowledges that implementing the recommendation of the Select Standing Committee would represent a significant step forward in achieving what we believe to be the correct policy. Nonetheless, it is our view that the recommendations made in our 1986 Report should be reconsidered for implementation before a new *Builders Lien Act* is finalized.

A principal way in which the approach of the Law Reform Commission differs from that of the Select Standing Committee is that the recommendations of the Committee are confined to priority competitions between construction lenders and builders lien claimants. The Commission's recommendations are wider in scope. If the priority position of the construction lender is to be rationalized, the position of future advances vis a vis builders liens should not be dealt with in isolation from other interests. Unless broader changes are made, the kind of relief contemplated by section 31(4) of Bill 52 may prove fruitless.

For example, one or more judgments may be registered against the property at about the same time as builders liens are. Those judgments would also have priority over the interest of the construction lender with respect to any further advances. While section 31(4) might allow the construction lender to assert priority over the liens with respect to further advances, he is unlikely to make those advances unless he also has priority over the judgment. The difficulty is that the priority of the judgment flows from section 24 of the *Property Law Act* and the court has no jurisdiction to alter that priority. This would not occur under the Law Reform Commission recommendations.

The interaction between the priority rules of Bill 52 and section 24 of the *Property Law Act* can also give rise to situations of "circular priority." A description of the circumstances in which this might arise is set out in an annex to this letter.

The other significant way in which section 31(4) diverges from the Law Reform Commission recommendations is that an application to court is required and the construction lender only receives priority if the court so orders. Under the Commission's recommendations, the lender would automatically have that priority without the necessity of obtaining a court order.

The result of the subsection is to create an unnecessary application to court which will burden both the parties and the justice system. It requires that before making an order, the court be satisfied that the advance in question will result in an increased value of the land and improvement, at least equal to the value of the advance. The reality is that this condition will be satisfied in virtually every case in which a lender will wish to make a further advance after liens have been filed. To make an advance which would not lead to increased value would be to throw good money after bad. Most construction lenders are economically rational beings who will not engage in irrational credit granting practices. The court is simply not required as a mechanism to screen advances in this way. Economic self-interest takes care of that.

A related concern is that not all judges are wholly sensitive to the realities of construction financing and may be less than sympathetic to applications by lenders which, on their face, suggest they are seeking an unjustified priority. The basis for this concern is the decision in *Yorkshire Trust v. Canusa Construction Ltd.* The reasons for judgment in the case are set out as Appendix C to the Commission's 1986 Report and the approach the court took in that case is the subject of comment at pages 33 and 34. The overall tenor of the *Canusa* decision suggests a failure by the court to fully appreciate the position of construction lenders and it may well be that lenders seeking an order under section 31(4) will face judge-made hurdles never intended or contemplated by the Select Standing Committee when making their recommendation.

In conclusion, for the reasons set out above, the Law Reform Commission recommends that section 31 of Bill 52 be reconsidered and that the priority position of the construction lender be rationalized along the lines set out in the Commission's 1986 Report.

This letter is to be taken as a Minor Report (No. 114) of the Law Reform Commission. This recommendation was approved by the Commission at a meeting on October 18, 1990.

Yours Sincerely,

Arthur L. Close, Q.C.,
Chairman

Enclosure

ANNEX

An Example of Circular Priority Arising under Bill 52

January 1:	Construction lender is granted a mortgage over the owner's land and the improvement. The mortgage is registered in the Land Title Office and the lender makes an advance under it (advance no. 1).
February 1:	Builders lien claimant commences work on the improvement.
March 1:	A creditor of the owner of the improvement obtains a judgment which is immediately registered at the Land Title Office. The judgment creditor gives notice to the construction lender.
April 1:	The builders lien claimant files a claim of lien in the Land Title Office.
May 1:	The construction lender applies to the court under section 31(4) for an order that a further advance have priority over the claimant's lien. The court makes the order.
June 1:	The construction lender makes the advance authorized by the order (advance no. 2).

It is clear that the construction lender has priority over all parties with respect to advance no. 1. Priority with respect to advance no. 2 is less clear. The result of the various provisions seems to be that the lender has priority over the lien claimant, the lien claimant has priority over the judgment creditor, and the judgment creditor has priority over the construction lender. This is a classic circular priority situation.

This result is arrived at through the application of the following rules and provisions.

Construction Lender has Priority over Lien Claimant

This is a result of the court order and section 31(4).

Lien Claimant has Priority over Judgment Creditor

This is a result of section 21 of Bill 52. Section 21 provides:

21. A claim of lien filed pursuant to this Act takes effect from the time work commenced or when the first materials were supplied for which the lien is claimed, and it has priority over all judgments, executions, attachments and receiving orders recovered, issued or made after that date.

Judgment Creditor has Priority over Construction Lender

This priority result flows from section 24 of the *Property Law Act*.