LAW REFORM COMMISSION OF BRITISH COLUMBIA

REPORT ON DEBTOR-CREDITOR RELATIONSHIPS

(PROJECT NO. 2)

PART II MECHANICS' LIEN ACT: IMPROVEMENTS ON LAND

LRC 7

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TO THE HONOURABLE LESLIE R. PETERSON, Q.C.
ATTORNEY-GENERAL FOR BRITISH COLUMBIA

The Law Reform Commission of British Columbia has the honour to present the following:

REPORT ON DEBTOR-CREDITOR RELATIONSHIPS
(Project No. 2)
PART II - MECHANICS' LIEN ACT: IMPROVEMENTS ON LAND

This Report concerns the *Mechanics' Lien Act*. It embodies recommendations concerning that part of the Act affecting the construction and mining industries; that is to say, it deals with liens in respect of improvements to land and with the statutory trust created by the Act. The Report does not make any recommendation with respect to liens on chattels, nor with respect to common law liens or liens arising under other statutes.

The Commission has undertaken a general study of Debtor-Creditor Relationships, which constitutes Project No. 2 in the Commission's Approved Programme. The present Report is the second to be submitted in furtherance of that study, the first being entitled "Debt Collection and Collection Agents."

INTRODUCTION

The Commission began its study of mechanics' liens in respect of improvements of land by requesting Messrs. R.C. Bray and B.D. Macdonald, two members of the Vancouver Bar with extensive experience in mechanics' lien matters, to act as advisers to the Commission and to prepare a paper containing their views and recommendations regarding the *Mechanics' Lien Act*, R.S.B.C. 1960, c. 238. On receipt of this paper, the Commission then undertook further research into the subject and in September, 1971, published a working paper containing the Commission's tentative recommendations. In accordance with the Commission's usual practice, the views and comments of persons in the relevant area of activity and of lawyers with knowledge and experience in this field were then invited. On the basis of the responses received, the Commission has been led to reconsider a number of its original proposals and to make certain additional recommendations.

During the course of preparation of this Report, the Commission was obliged to accept, with the greatest regret, the resignation of the honourable Mr. Justice Collier on his elevation to the Federal Court of Canada. The appointment of his lordship's successor, Mr. Ronald C. Bray, meant that as far as this particular study was concerned, Mr. Bray changed his capacity from that of adviser to the Commission to that of Commissioner.

The working paper evoked a reasonably widespread response both from people in the construction industry and from lawyers. There were some criticisms of a number of the individual proposals made by the Commission, although a considerable majority of the responses received were favourable. Only a small minority of respondents indicated they favoured repeal of the Act, Although most did not address themselves to that question. At the same time, it is fair to say that the difficulties that some members of the industry expressed concerning the present law were consistent with the view that the Act should be repealed. The Amalgamated Construction Association of British Columbia submitted a written brief to the Commission recommending a large number of individual amendments to the Act. The Association also called a meeting to consider the Commission's working paper and were kind enough to extend an invitation to Messrs. Bray and Macdonald and to the Commission's Director of Research. This meeting proved most helpful in gaining a clearer insight into the views of a number of members of the construction industry, some expressing their individual views and others acting as representatives of the members of the Association.

As far as the legal profession is concerned, responses to the working paper took two forms. Firstly, there were written responses and here a number of lawyers made additional suggestions beyond these contained in the working paper. Secondly, the British Columbia Commercial Law Subsection of the Canadian Bar Association considered the working paper at one of its meetings. This meeting was attended by some forty members of the legal profession and by Mr. Macdonald, Dr. Gosse and the Director of Research. The members of the subsection made a number of valuable criticisms and suggestions. Perhaps more significantly, a large number of individual lawyers expressed the view that the Act should be repealed. The meeting also passed by a large majority, with only one dissentient, a resolution recommending to the Commission "that they reconsider the alternative of abolition of the Act in part or *in toto*."

CHAPTER I WHY AMEND THE ACT?

The *Mechanics' Lien Act* was first introduced into British Columbia in 1879. In its ninety-year history it has been amended on thirty-one occasions. One might be forgiven for thinking that by now, ninety years and thirty-one amendments later, the Act[1] ought to have reached at least a state of satisfactoriness. Nothing could be further from the truth. Suggestions for change are frequent. Complaints concerning the operation of the Act are legion. The Act has been and continues to be a constant source of difficulty and irritation for these engaged in the construction industry and for their advisers.

But if the Act is still so unsatisfactory, despite the many attempts to improve it, one might then be prompted to ask whether this piece of legislation is likely ever to be made workable. What reason is there to suppose that the thirty-second amendment, if it came to pass, would be any better than the previous thirty-one?

Despite the unforseen snares awaiting anyone with the temerity to grapple with this difficult enactment, the Commission believes that the time is ripe for a re-examination of the principles underlying the Act.[2]

Two additional factors fortify the Commission's belief in the appropriateness of re-examination of the Act. Firstly, the amendments made over the years have tended to be piecemeal. Sometimes they have simply involved the wholesale addition to the Act of a new batch of provisions, as, for example, when the sections on costs were introduced in the 1903-04 Legislative Session, and when the provisions concerning chattel liens were introduced in 1939. Many other amendments have consisted simply in tampering with already existing provisions in an attempt to make their meaning clearer or their operation more smooth. There have been no changes in principle in the Act for sixteen years. The last major alterations to the Act came in 1948 when the trust provision was added, and in 1956 when the requirement of retention of a holdback was added. But these were not new. The trust provision was taken almost verbatim from a 1942 amendment to the *Ontario Act*, which in turn was taken from an amendment made in 1932 to the *Manitoba Act*; and the holdback provision was based on a formula first introduced into the *Ontario Act* in 1897.[3]

Secondly, the provisions of the Act are unsatisfactory from a technical point of view. They create a structure of rights without really explaining the nature of that structure or the way in which it is intended to operate. The legislation is essentially incomplete in that it leaves unanswered many fundamental questions concerning the effect of the basic protections provided in the Act. One result of this has been that on some matters, judges in different provinces have taken different views of the meaning of identical or similar provisions. It is impossible to ensure in the case of such an intricate piece of legislation the removal of all

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1. Throughout this Report, the "Act" is a reference to the *Mechanics' Lien Act*, R.S.B.C. 1960, c. 238, as amended, unless the context indicates otherwise.

2. This will not be the only review of the Act in British Columbia in modern times. In 1960, the British Columbia Branch of the Canadian Bar Association made several recommendations involving substantial changes. These were presented to the Select Standing Committee on Labour of the Legislative Assembly in 1961, but were not followed by legislative action.

3. *See An Act to Amend the Mechanics' and Wage Earners' Lien Act, 1896*, S& O. 1897, 60 Vict., c. 24, s. 2(1).

errors of omission and ambiguity. Nonetheless, the case law that has now built up around the Act serves to highlight a number of outstanding problems, and thereby assists in a reconsideration of the Act from a technical point of view. A re-examination of the Act ought to take account of this aspect, as well as the question of the principles underlying the Act.

In the last resort, however, the fundamental reason why the Act should be re-examined must be that it is causing injustice. The *Mechanic's Lien Act* is the subject of widespread and voluble dissatisfaction. Few there are that come into contact with the Act who are satisfied with its operation. Accordingly, the Commission has undertaken the task of examining the working of the Act with a view to proposing measures of improvement and reform.

CHAPTER II THE PRINCIPLES UNDERLYING THE ACT

1. The Position at Common Law

At common law, when one party agrees to sell services or goods to another in return for a price, if the person who so agrees performs his part of the bargain, but does not receive payment, he has a remedy against the purchaser of these goods or services under the law of contract. That remedy is an action against the purchaser for the amount owing under the contract. If the seller is successful in this action, he will be entitled to recover the amount due to him. But if it turns out that the purchaser is insolvent and cannot meet all his liabilities, rather than simply recoup what is due to him, the seller will have to stand in line with all the other general creditors of the purchaser. These various creditors will be entitled to share between them the unsecured assets of the insolvent purchaser in proportion to the amounts of their respective claims against the purchaser.

If there are ten creditors and the only substantial asset owned by the debtor is one which a particular creditor supplied, that creditor will not, unless he is a secured creditor, be able to claim that his debt should be satisfied first. The fact that he is the supplier of the insolvent person's only valuable asset will not give him any priority over the other creditors of the insolvent person. Goods once sold, or services once rendered, are absorbed into the general fund of the purchaser's assets. The person who gave credit has usually no right to reassert rights of ownership to the goods if he has not been paid; and the person who renders services generally has no right to claim that, in so far as the product of his services is represented by an asset in the hands of the debtor, the person who rendered the services should have the first claim to that asset.

Of course, it is perfectly possible for a seller of goods to contract for security from his buyer and in some types of transaction this is common; and it is possible, though perhaps not as common, for someone who renders services to insist, as a condition of rendering these services, that he is to receive some kind of lien or charge upon assets of the hirer of his services as security for payment. An obvious example of the former is the conditional sale of a motor vehicle. And in the case of real property, where there are many people in the business of providing money to finance the sale and purchase of houses and other types of real estate, the person who lends money will usually require security for his loan in the form of a mortgage of the premises. In the event of insolvency on the part of the purchaser of the motor vehicle by way of conditional sale, or of the owner of a house which has been mortgaged, the secured creditor will be in a stronger position than the other creditors. He will be able to realize the security and hence, to the extent of its value, claim payment of his debt in priority to the other creditors. But such a priority has to be bargained for and agreed upon between the parties. Without that, the creditor, even though he sold the car or financed the purchase of the house, will stand in no different position from the other creditors with regard to the house or car, or money produced by their sale, in the event of the debtor's insolvency.

2. A Departure from the Common Law

The effect of the *Mechanics' Lien Act* is to bring about a departure from the general principle of common law that in the absence of security being obtained by

bargaining for it, no security exists.[1] The legislation currently in force in British Columbia creates, in appropriate circumstances, two types of right, each quite different from the other. These two rights, which may co-exist simultaneously, or which may, according to circumstance, exist one without the other, are superadded to the general rights given by the law of contract to people who agree for a consideration to carry out construction work. The policy of the law, in supplementing a party's contractual rights with these two additional species of right, is to grant an extra measure of protection and security to certain classes of people engaged in the construction industry.

3. A Construction Contract

In order to understand the two species of right created by the *Mechanics' Lien Act*, it is essential to bear in mind the structure of relationships in a typical construction project. The owner of a piece of land who wishes to erect a building on that land, will generally employ a contractor, whose job it will be to see that the building is constructed according to specification. If the project is anything but the simplest, the contractor will employ subcontractors to complete parts of the work. The contractor will probably employ a subcontractor for the purpose of installing the plumbing and heating and another one for attending to the electrical installations, and others for more specialized work. The contract between the owner and the contractor is generally called the main, head, or prime contract and the contracts between the contractor and the various subcontractors are called subcontracts.

In addition to this, the contractor will probably need to purchase materials and perhaps to hire equipment in order to perform that part of the construction which he is undertaking personally. He will therefore enter into contracts with suppliers of materials and equipment. These persons who supply materials for use on a job, but do not themselves carry out work on the job, are called materialmen. Further, the subcontractor may also need to purchase materials or hire equipment, so he too will enter into contracts with materialmen. The subcontractor might also delegate part of the work to be done under the subcontract to someone else, in which case he will enter into a subcontract with a sub-subcontractor.[2]

An examination of the parties involved in a reasonably large construction project might therefore reveal the following: the owner, the contractor, several subcontractors, several sub-subcontractors and a number of materialmen. In addition to that, each of the parties will employ a number of workmen who have important rights under the Act. Bearing this structure in mind, it is possible to set out in simplified terms the two types of right which are created by the *Mechanics' Lien Act*.

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1. The Act is not of course the only piece of legislation which has this type of effect. *See e.g. Payment of Wages Act;* R.S.B.C. 1960, c. 45, ss. 5A and 8; *Municipal Act*, R.S.B.C. 1960, c. 255, ss 371(1), 378(1), 379(1); *Sale of Goods Act*, R.S.B.C. 1960, c. 344, s. 44(l)(a); *Workmen's Compensation Act*, S.B.C. 1968, c. 59, s. 49(1); *Execution Act*, R.S.B.C. 1960, c. 135, s. 35.

2. The Act itself does not distinguish between subcontractors and sub-subcontractors. Persons in the position of those described here as sub-subcontractors are included in the Act's definition of subcontractors. *See* s. 2.

4. The Trust Provision

Firstly, the Act provides[3] that all money received by a contractor or a subcontractor, on account of the contract price, shall be held in trust, and the contractor and the subcontractor may not appropriate that money to their own use until the workmen, materialmen and subcontractors have been paid. There still remains in the law some uncertainty as to precisely how the trust provision operates. But its general effect is to give priority to the claims of workmen, materialmen and subcontractors over any other claims to contract moneys in the hands of the contractor and subcontractor. If the contractor or subcontractor becomes insolvent, the classes of persons with priority are preferred to the general creditors in the distribution of building contract moneys in the hands of the contractor or subcontractor. In addition to that, if a solvent contractor or subcontractor tries to use contract money to repay a debt or if he assigns a debt of contract money to someone else as security for a loan, the beneficiaries of the trust money may be entitled to claim against the person into whose hands the contract money comes.

The purpose of this provision is to ensure that these persons who participated in the construction project receive their share of the remuneration paid by the owner to the contractor for completing the project, and to prevent the contractor or the subcontractor from diverting contract money to a purpose unconnected with the project.

5. The Lien and Holdback Provisions

Secondly, the Act provides[4] that the workmen, materialmen, subcontractors and contractors who contribute services or materials to a construction project are entitled to a lien on the building, the land and the materials placed on the land. The lien provision turns the owner's interest in the land into a security for the amount owing to the lien holders.

The Act also creates a scheme for adjusting the competing interests of the lien holders in getting paid and of the owner in enjoying his property free from interference. It provides[5] that when the owner pays money over to the contractor, either on the completion of the project or from time to time as the project progresses, he shall hold back 15 per cent of any amount owing to the contractor. If for one reason or another any of the people in the construction chain are not paid by the contractor out of the money he has received from the owner, they may wish to exercise their lien rights. They are entitled, for this purpose, to claim against the money held back by the owner. If the owner has acted properly and complied with the provisions of the Act, he will not be liable for any amount which would bring the total amount of his payments above the amount he agreed to pay in the original contract. At the same time, as a result of the owner having held back 15 per cent of the money owing to the contractor, there is money available to help meet the claims of the unpaid lien holders.

6. The Basis of the Act

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3. S. 3

4. S. 5

5. S. 21

The aim of the Act is to assist these who provide materials and services on a construction project in obtaining payment. But that is not in itself a sufficient analysis of the *raison d'etre* of the Act. There are many classes of persons to whom others incur debts and yet the law does not grant them any special rights of security or priority. And indeed it could not do so. If the law sought to give the same or an equivalent type of protection to all persons to whom others incurred debts, it would succeed in protecting no one. Protection of one class of creditors can be purchased only at the price of rendering another class more vulnerable. Protection for everyone is protection for no one. The fundamental question is, therefore, why a particular class of persons construction industry enjoys a protection over and above what is given to creditors generally.

The world of trade and commerce is built on the credit system, and there has grown up a class of persons employed in facilitating the operation of the credit system. This is not itself a new phenomenon. But what is relatively new is the spread of the credit system from these sectors of the community engaged in commerce to all sectors of the community, until today even the most simple everyday retail transaction will frequently be conducted on credit terms. The result of this expansion of the credit system has been a corresponding expansion in the use of the secured transaction. A person who wishes to sell his wares, whether they be goods or services, will frequently be prepared to give credit in order to do so; but at the same time he will want to obtain as much protection as he can in order to ensure that ultimately he will be paid.[6] If the seller is not able to obtain the desired security, he will be less inclined to part with his goods or provide his services without being paid for them at the same time. The credit system depends very much upon the ability of a seller of goods or services to be able to say to his buyer, "I am prepared to wait for my money, provided that some special protection is given to me so that if some financial setback overtakes you before I am fully paid, I will not be affected by it, or at least I will be given preferential treatment over your other creditors. If it is a question of choice between paying them or me, I require that you be obligated to prefer me."

The methods of providing the security on which the credit system rests are various. Some types of security suit one kind of transaction, some another. The purpose of the security however, is the same in all cases. It is to minimize the risk of the creditor who is awaiting payment. In some situations, the amount of credit which a purchaser needs exceeds what the seller is prepared to grant even with ample security. Transactions involving real property typically fall into this class. Such transactions are ideally suited to the provision of credit in view of the comparative durability of the security that can be given in return. But for a variety of reasons a seller will often require reasonably prompt payment of the purchase price. As a consequence, the credit sought by the purchaser is provided by financial institutions which, in effect, sell money in return for payment of a larger sum over a period of time, secured by mortgage. From the buyer's point of view the mortgage transaction is the equivalent of buying on credit.

Most building construction is financed by way of mortgage. Ideally, this means that the persons engaged on the construction itself will not be called upon to give credit. Just as this function is carried out by the mortgagee in the case of

6. The courts did not at first accept the extension of the system of secured transactions into the retail area with equanimity. The early history of the device of "hire and purchase" in England was one of the seller of goods on credit endeavouring to protect himself against non-payment on the part of the purchaser by retaining a right to reclaim the goods, whilst the courts endeavoured to deny the seller's security in the goods by treating them as part of the general fund of the buyer's assets which he was free to dispose of as he wished. *See Lee* v. *Butler* [1893] 2 Q.B. 318 (C.A.).

a sale of a house, so it should ideally be carried out by the mortgagee in the case of a building construction. In practice, however, this is unlikely to happen. The landowner may be contracting for a building worth several hundred thousand dollars or more. He is prepared to pay the price for his finished building, but what is to happen while it is under construction? The money being spent in the course of construction is not producing a proportionate value to the owner as long as the building remains unfinished. The situation is unlike a contract for the sale of goods by instalments where, generally speaking, after delivery of the first of four equal instalments the buyer will have received a quarter of his value simply because a quarter of the money allocated to the project has been spent. In fact, as an income earning asset, the one-quarter finished building is useless. It may have a resale value greater than that of the site in its unimproved state, but not one likely to result in profit to the owner. The owner will want to see positive results from his builders before he pays out large sums of money. And the mortgagee will want to ensure as far as possible that the value of his security is not outpaced by the rate at which he makes mortgage moneys available, and will retain sufficient mortgage funds to meet the cost of completion of the building. Consequently the owner and the mortgagee will be looking for some form of credit from these engaged in the construction process. The builders themselves, like other people engaged in trade and commerce, will feel the pressure to provide credit. And, again as in other sectors of trade, the measure of their credit-granting propensity, and of their exposure to risk through an extension of credit, will be a function of the security they are able to obtain.

What type of security is available for persons who participate in the construction of a building? Such persons face two particular difficulties. Firstly, the legal relationships between the parties to a large construction contract are complex. There are many parties involved and most of the people looking for security as a basis for providing services on credit have no contractual relationship with the owner. Secondly, the services and materials supplied by a subcontractor or materialman soon lose their separate identity and become part of the land, so that the right to repossess in the event of non-payment would be meaningless in the building context. The facts surrounding a building project, both legal and physical, make difficult the operation of a security system on which to base the credit system.

The effect of the *Mechanics' Lien Act* is to inject into the construction context a statutory basis for the operation of the security system and hence the credit system. It brings about by statute what in other and more straightforward situations is brought about by agreement of the parties. The operation of the credit system is a feature of most areas of commercial activity. Usually it has arisen through natural growth. In the construction industry, it has been nurtured artifically by the *Mechanics' Lien Act*.

7. Liens on Chattels

In addition to creating rights of lien and rights under a trust in favour of whose who contribute to an improvement on land, the Act also contains several provisions in relation to liens on chattels. The Act does not itself create any new species of lien in respect of chattels, since liens on chattels in favour of various classes of persons who do work or provide services are a familiar feature of the common law. But the common law lien does not give a right of sale to the lien holder. He is allowed to retain possession of the chattels as security for payment for his services, but nothing more. The Act provides a right of sale of goods subject to a lien and a procedure according to which the sale is to be conducted.

The Commission is not at the present time prepared to make any recommendations with respect to liens on chattels. Although they are dealt with in the same Act as liens in favour of people engaged in building construction, the Commission feels that they are a separate subject and examination of them should take place separately from examination of liens in respect of improvements on land.

8. Other Types of Liens

Apart from the *Mechanics' Lien Act*, several other statutes also create liens.[7] Most of these arise in situations having little to do with the security interest given to persons who contribute to an improvement on land. But one such Act does raise analogous points of philosophy and principle. It is the *Woodmen's Lien for Wages Act*, R.S.B.C. 1960, c. 411, as amended. This Act creates a lien in favour of persons who render services "in connection with any logs or timber,"[8] for the amount owing to them.

Certain observations concerning the Act made by Branca J.A. in *DeCook* v. *Pasayten Forest Products Ltd.*[9] have been drawn to the attention of the Commission.

That learned judge said:[10]

> It would not seem amiss if our legislators could give thought to modernization of this remedial and protective statute for these who work in the leading industry of this Province to at least determine with some definitude the scope of its application in this involved and integrated industry, as well as to clarify the extent to which people who work in it are intended to be covered and protected thereby.

The Commission has accordingly conducted a preliminary survey of this Act. But it stands in a very different position from the *Mechanics' Lien Act*. It has not received anything like the same amount of publicity and scrutiny as the *Mechanics' Lien Act*. In view of the comparative dearth of data and information, the Commission has decided not to make recommendations with regard to the Act at this time, but instead will be inviting suggestions and comments concerning possible reforms from all interested parties. On the basis of these suggestions and comments, the Commission will then conduct a more thorough study of the *Woodmen's Lien for Wages Act*, with a view to determining whether changes should be recommended.

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7. *Supra*, p.16, note 1

8. S. 3(1)

9. (1961), 60 D.L.R. (2d) 280

10. Idem, at p. 286

CHAPTER III THE HISTORY OF MECHANICS' LIEN LEGISLATION

1. Generally

The secured rights over construction assets afforded to these who participate in the construction are unknown to the common law.[1] They are creatures of statute. Statutes creating this type of right to priority originated in the United States of America, in Maryland in 1791. In the first half of the nineteenth century, several states enacted legislation designed to secure rights of priority over construction assets. Today, such legislation is almost universal in the United States.

In the Commonwealth, the response to the American example has been varied. No similar legislation has ever been enacted in the United Kingdom. Similar legislation was enacted in New Zealand, where it is still in force, and in two states in Australia, Queensland and South Australia. The former of these two states repealed its Act in 1964. Legislation of this type first found its way into Canada in 1873, when Ontario and Manitoba adopted a *Mechanics' Lien Act*. Since that time, all the common law provinces have followed suit, and there now exists a *Mechanics' Lien Act* in every common law province, and in the territories.

2. In British Columbia

A *Mechanics' Lien Act* was first introduced into British Columbia in 1879.[2] It was amended in 1881 and 1885. It was then consolidated in 1888 and the 1879 Act and the two amendments were repealed. Also in 1888 the *Protection of Workmen's Wages Act*[3] was passed. The two 1888 Acts were then consolidated in the 1838 general consolidation and the Act appeared as the *Mechanics' Lien Act*, Consolidated Acts, 1886, c. 74.

The 1888 Act was amended in 1889 and in 1890. The 1888 Act plus the amendments of 1889 and 1890 were, along with further amendments, then consolidated to form the *Mechanics' Lien Act*, 1891, c. 93.

The Act appeared in the 1897 Revision under the authority of the *Revised Statutes Act*, 1895, and in this Revision, a section was added dealing with registration of affidavits under the Act.

The Act was then amended in 1900 and 1907. In 1903-4, several sections were added to the Act dealing with costs in mechanics' lien actions. The Act, plus the amendments, were then consolidated and appeared in 1910 as the *Mechanics' Lien Act*, *1910*, c. 31. This Act, with one or two additions, omissions and amendments then appeared in the 1911 Revision of the Statutes.

Between the 1911 Revision and the time of the next Revision in 1924, there were two amendments, in 1917 and in 1921.

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1. They are a well known feature of the civil law and were inherited from Roman law.

2. The *Mechanics' Lien Act*, *1879*, 42 Vict., c. 24.

3. Statutes of British Columbia, 1888, c. 40.

The Act was further amended in 1926-27 before being consolidated, with a further slight amendment, in the 1936 Revision, to become the *Mechanics' Lien Act*, R.S.B.C. 1936, c. 170.

Before the next Revision, the Act was amended a further six times, in 1937, 1938, 1945, 1947 and 1948. The trust provision was introduced into the Act for the first time in the 1948 amendment. The provisions for dealing with liens on motor vehicles were introduced in the 1939 amendment. The 1934 Act together with the six amending statutes were then consolidated in the 1948 Revision.

Amendments were then made to the Act in 1949, 1950 and 1951; and in 1956, the 1948 Act and the subsequent amendments were repealed and replaced by a new Act, together with further amendments. This Act appeared as the *Mechanics' Lien Act*, *1956*, c. 27, and introduced the requirement of a holdback into the law of British Columbia for the first time.

Between the enactment of the 1956 Act and the 1960 Revision, there were two further amendments, in 1957 and 1959. The Act appeared in the 1960 Revision as the *Mechanics' Lien Act*, R.S.B.C. 1960, c. 238.

Since the 1960 Revision, there have been four further amendments, in 1961, 1965, 1969 and 1970.

It is clear from the history of the *Mechanics' Lien Act* that there has been a need for substantial and frequent amendments. Not all of the amendments referred to contain important changes of principle. On the other hand, there has been a significant number of additions and alterations of principle in the Act from time to time. Perhaps the most significant of these occurred in 1939 when the motor vehicle provisions were introduced, in 1948 when the trust provision was introduced and in 1956 when the holdback provisions were introduced.

CHAPTER IV RECENT REFORMS AND PROPOSALS FOR REFORM OF MECHANICS LIEN LEGISLATION

The mechanics' lien legislation has been the subject of continuous debate in a number of provinces. The frequent amendments and reforms that have taken place in British Columbia are part of a consistent pattern throughout Canada and in recent times various bodies and committees have suggested recommendations leading to these reforms. The Commission feels that there is a great deal to be gained from considering the views and experience of other provinces when recommending changes in the law of British Columbia. The following proposals for reform, which have emanated from other provinces and from British Columbia itself, have been considered by the Commission in preparing this Report.

1. British Columbia

Over ten years ago, the British Columbia Branch of the Canadian Bar Association submitted a brief to the Select Standing Committee on Labour of the British Columbia Legislative Assembly in which two alternative recommendations were made concerning the Act. It was recommended either that the Act be repealed except so far as it grants liens to workmen and garagemen, or that instead of repeal, substantial amendments be made to the Act. These proposals for amendments concerned a number of different aspects of the Act, in particular, competing rights as between an assignee of contract moneys and a materialman or subcontractor, summary determination of the owner's liability and removal of liens, expiry of the time for filing liens, priorities on distribution of payments into court, the situation where the owner acts as his own contractor, and certain others of a procedural nature. Neither the recommendation of repeal nor the alternative recommendations of amendment were implemented.

2. Alberta

In 1966, His Honour Chief Judge Buchanan was appointed Commissioner under the *Public Inquiries Act* of Alberta to enquire into the adequacy of the provisions of the Alberta *Mechanics' Lien Act*. His Honour's Report, submitted in November, 1967 led to substantial amendments being made to the Alberta legislation, and they appear in the form of *The Builders' Lien Act*, Statutes of Alberta, 1970, c. 14, and then in the Revision which took place in Alberta in 1970 as *The Builder's Lien Act*, R.S.A., 1970, c.35.

3. Saskatchewan

In 1962, The Nonourable Mr. H.F. Themson, Q. C., was appointed Commissioner under the *Public Inquiries Act* of Saskatchewan to inquire into and make recommendations concerning the Saskatchewan *Mechanics' Lien Act*. He reported in 1963, but his recommendations were not followed by alterations to the *Saskatchewan Act*.

4. Ontario

In 1966, the Ontario Law Reform Commission submitted a Report to the Attorney General for Ontario proposing amendments to the Ontario *Mechanics' Lien Act*. As a result of that Report a Bill was drafted and comments were invited. The Ontario Law Reform Commission then produced a supplementary Report in

1967, and a new Act was passed entitled *The Mechanics' Lien Act, 1968-69*, S.O. 1968-69, c.65. The new Act contains some important amendments based on the Report of the Ontario Law Reform Commission.

5. Canada

Between 1923 and 1949, the Conference of Commissioners on Uniformity of Legislation in Canada produced a series of draft Acts. But the attempt to achieve uniformity throughout Canada was then abandoned owing to the difficulty of securing general acceptance of these model acts.

CHAPTER V SHOULD THE ACT BE REPEALED?

1. The Argument in Favour of Repeal

The Commission was impressed by the weight of argument received suggesting directly or indirectly that repeal of the Act would be desirable. The argument took several forms, mostly radiating from the same central thesis that the Act creates more practical difficulties than can be justified by whatever merit it may have in principle.

It is well known that many members of the legal profession have for long favoured repeal of the Act. At a meeting of the British Columbia Commercial Law Subsection of the Canadian Bar Association at which the main item on the agenda was the Commission's working paper on the *Mechanics' Lien Act*, a resolution was passed requesting the Commission to reconsider the question of repeal of the Act. That meeting was attended by approximately 40 lawyers, several of whom did not vote, but only one of whom opposed the resolution.

In addition to this the Commission has discovered that within the construction industry itself, there is a considerable body of opinion that believes the main problem to which a reform of the law of mechanics' liens should address itself is that of the flow of funds along the construction chain. Few members of the industry were prepared to go so far as to say that they favoured repeal, but the view that effort should be concentrated in the direction of removing restraints on the flow of funds argues in favour of repeal.

The Commission considers the following to be the main arguments in favour of repeal:

(a) The Act slows down the flow of funds along the construction chain

Perhaps the argument voiced most strongly against the provisions of the Act is that it has an inhibiting effect on the flow of funds along the construction chain. The holdback provision requires that 15 per cent of all moneys which become available for payment to the contractor shall be retained by the owner. The effect of this is that there is an obligatory extension of credit to the owner of 15 per cent. Frequently, the amount by which a particular individual in the construction chain remains unpaid exceeds 15 per cent, since holdbacks have a tendency to mushroom and some head contractors try to retain 30 to 40 per cent of the moneys received by them from the owner.

Some members of the construction industry expressed the view that the protection afforded by the Act was not worth the price that had to be paid in terms of losing the use of 15 per cent or more of their money for extended periods of time. They pointed out that the lien rights are seldom of any great value and generally are equivalent only to salvage. It should be clearly stated that neither the Amalgamated Construction Association of British Columbia nor the individual organizations within the construction industry who communicated with the Commission, declared themselves in favour of repeal. But the logic of their main criticism of the present law is consistent with the view that the Act should be repealed.

The policy of the Act is to ensure that people engaged on a construction project are paid. This policy is implemented through a requirement that moneys which would otherwise have been payable to these people are set aside for the time being. A system which gives protection to the people at the end of the construction chain by requiring these at the beginning of the chain to hold back moneys which are contractually due and owing, is bound to result in a slowing down of the flow of funds along the chain. Thus, the device used to ensure that eventually people in the chain are paid itself creates a pressure tending, in the short run, to prevent them getting paid.

In an economic climate where cash is readily available and where the contractor has sufficient resources to finance his subcontractors for a period of time, this may not be a major problem. In the environment of today's construction industry, however, there is little doubt that the requirement in the Act that the owner retain a holdback of 15 per cent serves to slow down substantially the flow of funds along the construction chain. It is also noteworthy that, as buildings have tended to get larger in the post-war era, the amount of the holdbacks retained under the Act has increased and hence the amount of credit which these engaged in construction are statutorily obliged to give to the owner has also increased.

(b) _The Act induces a false sense of security

Some suppliers are apparently willing to supply goods on credit to subcontractors without worrying unduly about the financial strength of the subcontractor they are supplying. They are induced to do this in the belief that *The Mechanics' Lien Act* gives them sufficient protection to make it worth their while.

In some instances, this belief will turn out to be well founded, and if the subcontractor goes bankrupt, they will be able to recover sufficient money under their lien rights to make the venture profitable. In the majority of cases in which the project turns sour, however, the sum recovered by the supplier in a mechanics' lien action will be too small to prevent the supplier from suffering a substantial loss. Clearly everything depends on the circumstances.

The problem created by this aspect of the Act is not confined to the false sense of security, literally and metaphorically, which it may give to some people in the industry. The fact that suppliers are often induced to give credit to people without really examining their credit-worthiness has broader implications than the possibility that the supplier will suffer a loss. It means that if the contractor or a subcontractor suffers a loss on a particular protect, such that he is potentially bankrupt, he may be able to stay in business for a period of time by taking new jobs, obtaining further supplies on credit and using money he receives from the now jobs to pay off the more pressing debts he incurred on the old job. The willingness of the supplier to grant him credit, based at least in part on the existence of the supplier's right to file a lien under the Act, may enable a contractor or subcontractor to blaze something of a trail of debts unpaid and unpayable. In such a situation the fatal consequences to the contractor or subcontractor, suffered on a particular job, do not become apparent until several jobs later.

If the Act were repealed, suppliers would be less ready to extend credit in a carefree fashion to subcontractors, who in turn would not be in a position to run up such substantial debts before their impending bankruptcy were revealed.

(c) _The Act's technical difficulties

It has already been mentioned that the Act is an awkward piece of legislation. Its provisions are intricate and ambiguous and its concepts are incompletely fashioned. The reason for this is that, as pointed out earlier, the tendency of the amendment process has been to take a new subsection from one province and then to add another subsection from a different province. Such a pattern of piecemeal reform is hardly likely to produce a clear and consistent piece of legislation, a thesis amply borne out by the *Mechanics' Lien Act*.

The technical problems should not be exaggerated however. They are largely drafting problems and as such are surmountable. Nonetheless, it must be taken into account that interpretation of the Act remains a source of difficulty, despite the extensive experience that the provinces have had with it. Although specific points of difficulty and ambiguity can be corrected, it would be over-optimistic to believe that all ambiguity can be eliminated. The context in which the Act applies is legally very complex, involving many different parties with different claims and defences. If the Act were repealed, difficulties of a technical nature created by it would be removed.

(d) _The Act is an instrument of blackmail

One of the most serious problems of the Act is that the filing of a lien can have such serious consequences for the owner in terms of slowing down work on the job, that the threat of filing can be a powerful weapon in the hands of an unscrupulous subcontractor. This would not be such a serious problem if there were a process available to the owner or contractor by which, on the giving of adequate security, liens could be summarily removed. Under the present law, this can only be done by paying the lien claimant or by way into court the amount of the lien claim, even Though the claim may be in excess of the maximum possible amount of the owner's liability. This situation could be improved by establishing the necessary interlocutory procedure. But it is unlikely that the possibilities for blackmail inherent in the Act can ever be completely removed as long as everyone engaged on the construction project has the right to encumber the owner's title.

(e) _The Act is unjust

Most of the comments made to the Commission concerning the Act related to its practical operation and to the collateral effects upon the industly produced by the provisions of the Act. There was little comment concerning the basic philosophy of the Act and the justice of the protection provided by it. The main concern of people who are affected by the Act seems to be to find a way of making it possible to live with the Act in a practical sense, rather than ensuring that the Act embodies a fair and just social policy.

From the point of view of policy, a simple argument against the continued existence of the Act is that it gives a measure of protection to a particular class of people, which not only does not exist in the case of other sectors of the community, but which actually operates to the detriment of other sectors of the community. That is not to say that every time a successful lion ciaimant walks out of Court the man the street has suffered. He may have done in a very indirect and marginal sense, since some of the persons who suffer directly are the other general creditors of the person whose default precipitated filing of liens.

An example will demonstrate the point. The contractor goes bankrupt

halfway through a job. He has received a number of progress payments for the work he has done. He engaged suppliers of various materials in connection with the job and should have paid these suppliers out of the progress payments he received. Instead, he used part of the payments in an effort to ward off his other creditors. The materialmen now file liens. At least they will have access to the holdback of 15 per cent. That 15 per cent might go a considerable way toward meeting their claims.

If the suppliers did not have this right, they would have to prove in the contractor's bankruptcy. This would probably yield very little. That is the advantage which the lien claimant enjoys. At the same time, the result of that advantage is that certain sums of money, which might otherwise have gone into the insolvent's estate and have been available for his general creditors, will not now do so. To the extent that amounts owed to the bankrupt contractor are, by virtue of the holdback, kept out of his estate, the other creditors receive less in the distribution of the bankrupt contractor's estate. They are, therefore, the primary sufferers and it is at their expense that they lien claimant is given special protection.

2. The Argument in Favour of Retention

It is possible to make a case for saying that the special protection given by the Act to persons in the construction industry is justified and should be retained. In this working paper, the Commission tentatively suggested on the basis of this argument that the Act should not be repealed.

The argument is that the factual circumstances and legal relationships involved in a construction project create a very difficult situation for the subcontractor or materialman seeking some form of security for payment in return for being prepared to undertake the work. There is no ready-made peg on which to hang the security as there is in the case of the mortgage of a house or a simple sale of goods. The only obvious candidate is the land and building itself, and this is of course the technique used in the Act.

To repeal the Act and to leave the materialman and subcontractor to try and obtain a lien or charge against the land by agreement with the owner, would probably result in the disappearance of any form of security in favour of the materialman and subcontractor. The strength of competition between subcontractors, the lack of even a contractual nexus between subcontractor and owner and the reluctance of the mortgagee to allow the owner's title to become encumbered would all operate to make it unrealistic to suppose that the subcontractor would be
able to bargain with the owner for security.

If the effect of repeal of the Act would be to eliminate the ability of the subcontractor and materialman to obtain security, the question becomes, how important is that security? It might be argued that the proper antidote for the subcontractor and materialman would be to insist on cash on delivery.

In fact this is unlikely to occur. Firstly, we live in an economy based upon credit. Practices and expect in many sectors of industry and commerce have crystallize around a sat of assumption about credit. To alter the law so as to remove the underpinning for a grant of reasonable credit, thereby making insistence on cash on delivery the only rational mode of behaviour with respect to the terms of payment, would be an attempt to stem a tide that is already

powerful, is promising to become ever more powerful and which flows in precisely the opposite direction from the cash transaction.

Secondly, there are inevitable delays between the time at which a piece of work is done and the time at which a progress payment for that piece of work is made available. The situation could only be improved with the additional administrative cost of making progress payments more frequently than once a month. Even so, time-lags could never be entirely eliminated since the architect must still prepare his certificate and submit it to the owner, who must then obtain a mortgage draw from the mortgagee and present a cheque to his contractor; the contractor must then pay his subcontractors who in turn will pay their materialmen. Quite apart from delays caused by the time between one monthly accounting period and the next, the very process of administering payments itself involves time-lags.

When a materialman supplies materials, or a subcontractor does work, he knows that the money which is going to be used to pay him has not yet flowed along the construction chain and that he will have to wait at least until the next progress payment before he is paid. It is therefore impracticable for the materialman and subcontractor to insist upon cash. If they wish to stay in business and not drive their customers away to their nearest competitor, it is hardly surprising that the materialman and subcontractor will be wooed into granting short-term credit by the lure of a large contract.

Thirdly, if the subcontractor does not get paid promptly, he is in a difficult position. If he walks off the job he runs the risk of never being paid. But if he carries on with the job, he can reasonably expect that this will aid the flow of money from the owner to the contractor and then to the pressure on him is thus very strong to grant even more credit in the hope of recovering payment. Perhaps some subcontractors give credit recklessly in this situation. Perhaps if the right of lien were withdrawn they would be forced to weigh more carefully the question whether to commit themselves even more deeply or whether to withdraw. But many projects experience temporary dilficulties which are resolved without the job having to be abandoned. To expect the subcontractor to insist on cash on delivery is unrealistic. The practicalities of the situation and the pressures to which the subcontractor is subject force him to extend a measure of credit to the party employing him. If he is reckless in the extent to which he grants credit he has only himself to blaze. But there should be some measure of security for a grant of reasonable credit.

It is also possible that the Act has a beneficial effect on many projects which tends to go unnoticed. The Act may exert a pressure on contractors and subcontractors to keep the money they receive from the owner on a particular job within the pyramid of persons engaged on that job. The possibility of imprisonment or fine for breach of trust may have deterrent function, although prosecutions for breach of trust are rare. In addition, the possibility that a lien may be filed, with consequent annoyance for the owner and the contractor, may cause them to police the paying habits of their subcontractors a little more carefully than they otherwise would. It is a matter of conjecture to what extent these aspects of the Act are effective in preventing projects from turning sour when, but for the existence of the Act, they might have done so.

3. The Commission's Conclusion

As stated earlier, a number of the responses to the working paper, and

suggestions received since, favour repeal, rather than amendment, of the Act. In several cases, the proposal was for repeal of its provisions insofar as they relate to contracters, subcontractors and materialmen, leaving the Act applicable only insofar as it provides a secured position for workmen.

The Commission has been impressed by the cogency of these suggestions. The Commission was aware of the arguments in favour of repeal and referred to them briefly in the working paper. What we did not appreciate before the working paper was distributed was how keenly many members of the construction industry itself felt the force of these arguments. Although in the working paper the tentative conclusion was that the Act should be retained but substantially amended, these suggestions, together with the resolution of the Commercial Law Subsection, have led the Commission to reconsider the position and weigh again, at least in principle, the pros and cons of repeal and amendment.

We say "at least in principle" because there is, at present, little factual evidence upon which to base a judgment. There is factual evidence as to the results of, or as to the situation created by, the present legislation. But there is none, at least in Canada, as to the situation which would result if there were no such legislation. It has been possible, on the basis of the present situation, discussions carried on in response thereto, to reach certain definite conclusions as to amendments and improvements, and to feel reasonably certain as to the results which would follow from their acceptance. But it has not been possible on the basis of our present information for the Commission to reach such conclusions with respect to the results which would flow from repeal.

It is the view of the Commission that, in dealing with matters of this kind, where substantial segments of business and labour have fashioned their practices of existing laws, aid far-reaching economic effects may be expected to flew from alterations therein, repeal should not be recommended unless the results (and the balance of benefits) can be reasonably certainly measured and forecast. In British Columbia, as throughout Canada, the entire construction industry and all subcontractors and materialmen engaged therein, and their employees, carry on their activities on the basis of the existence of a *Mechanics' Lien Act*.

It is possible that repeal of the Act would have far-reaching consequences in terms of the structure of relationships within the construction industry. Any recommendation in favour of repeal would therefore need to be weighed most carefully and could only be made after a thorough assessment of the likely consequences.

The study necessary would involve exhaustive research, discussion, and testing of hypothetical conclusions with representatives of the construction industry, materialmen, workers' representatives, financial institutions - the whole spectrum of the economy inolved. Because of the largely hypothetical nature of the considerations, the testing of conclusions would require an in-depth study which at the moment is beyond the resources of the Commission.

We have had considerable discussion and exchange of information and views in connection with our working paper, but this proceeded on the basis of a tentative recommendation for amendment, not repeal. The Commission feels that before it could properly make a recommendation for repeal, we would also have to recast the working paper accordingly to give these concerned a fair opportunity of assessing the situation and making an adequate response.

It is also the Commission's strong view that before reaching any firm

conclusion there should be a study of the experience in the one comparable jurisdiction which did have a mechanics' lien system but has repealed it, that is Queensland, Australia, and of the experience of jurisdictions, such as England, which have never had a mechanics' lien system. This again would demand time and resources presently not available to us.

For these reasons the Commission finds itself unable at the present time to recommend outright repeal of the Act. To these who favour repeal of the Act, the Commission's stance may seem unwarrantedly cautious. The Commission's stance however that if its recommendations are adopted, they will go a considerable way towards removing most of the problems caused by the Act. The recommendation that holdbacks be retained separately (i.e. by the contractor and subcontractor) and the recommendation that the provision of labour and material payment bond should be an alternative to the lien and holdback system should both to a solution of the problems caused by the slowing-down of the flow of funds along the construction and the recommendation that the owner be entitled to his liens cleared by paying into court the statutory amount of the holdback plus any other sums owed should contribute to a solution of the problem caused when the temptation felt to abuse the rights given to lien claimants by the Act.

In addition to this, the Commission intends to keep under review the consequences that follow from adoption of the Commission's recommendations assuming that they are adopted.

The remainder of this Report therefore deals with the problems created by the Act and the recommendations for their solution or alleviation within the context of a modified mechanics' lien system. We believe that our recommendation for the abolition of the holdback provisions where there is a satisfactory labour and material payment bond will create a substantial improvement in one of the areas of greatest concern, and the experience that develops therefrom will afford a valuable basis for consideration of further changes - including repeal itself.

The Commission wishes to make it clear that it is not opposed to repeal, either in this particular case or as a measure of reform generally. We are prepared to pioneer, but there is a difference between pioneering in an area where no paths exist or have been charted, and pioneering in an area where the routes have become well-defined and substantial and legitimate interests have become well established along these routes. In the latter type of situation the proper function of the pioneer or reformer, we believe, must first be to establish that the change will be beneficial.

We are satisfied that the reforms recommended here will be beneficial; we cannot at the moment demonstrate conclusively that the balance of benefit lies in favour of repeal.

One member of the Commission, Mr. R.C. Bray, has from the outset been prepared, and is still prepared, to recommend repeal on the basis of his experience of the present Act and his consideration of the arguments in favour of repeal summarized in the foregoing. However, he accepts the position that the Commission as a whole does not recommend repeal, but rather substantial amendments; and on the basis that, if there is to be a *Mechanics' Lien Act*, the proposed reforms are infinitely better than the present legislation, he has signed and supports this Report and its recommendations.

CHAPTER VI THE LIEN AND HOLDBACK

1. The Basic Provisions

(a) The lien

Section 5 of the Act provides:

> Subject to this Act, a workman, materialman, or subcontractor who does or cases to be done any work upon, or supplies material, or does both work and supplies material, to or for an improvement, for an owner, contractor, or subcontractor, has a lien for wages or for the price of the work or material, or both or any of them, or for so much thereof as remains owing to him, upon the interest of the owner in the improvement, upon the improvement itself, upon the material delivered to or placed upon the land upon which the improvement is situate, and upon the said land.

This section grants to the prescribed classes of persons a right of lien. The right is given to assist the prescribed clauses in recovering money owing to them as a result of their contribution to improvements on land. The right is available against the owner of the land on which the improvement was effected and it operates as an encumbrance on the owner's title to his land. In the normal course, the existence of this encumbrance will result in the lien claimants being paid, or a settlement being made. But if they are not paid, and no settlement is reached, the ultimate remedy is for the lien claimants to request that the court direct the property be sold[1] and to claim payment of the amount properly owing out of the proceeds of sale.[2]

This right to a lien for money owing in respect of work or material is qualified by section 6 of the Act, which limits the liability of the owner to the amount payable by the owner to the contractor.[3] The lien claimant may be the contractor himself, or he may be further down in the chain, e.g., a subcontractor or materialman. In any event, the total amount for which the owner will be liable to all claimants is the amount by which he is still indebted to the contractor, provided that amount is equal to 15 per cent of the contract price.

(b) The holdback

In addition to providing for the basic right to a lien, the Act goes on to establish a framework within which the lien provision is to operate. This is the holdback provision. It requires in section 21 (1) that

> ... the owner or person primarily liable upon any contract under or by virtue of which a lien may arise shall retain for a period of forty days after the contract has been completed, abandoned, or otherwise determined, fifteen per centum of the value of the work, service, and materials actually done, placed, or

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1. Under s. 30(2)

2. It will be seen from this that the statutory lien granted under the Act in favour of the protected classes in this respect is a more valuable right than a lien at common law. The latter does not carry with it a right of sale in the event of non-payment.

3. Although limitation of the owner's liability is the general rule, there are circumstances in which the owner may lose this protection. *See* the requirement of "good faith" in s. 21(3).

furnished ...

Section 21 (2) then goes on to provide:

> A lien is a charge upon the ament directed to be retained by this section in favour of claimants whose liens are derived under persons to whom the moneys so required to be retained are respectively payable, or whose liens are filed as in this Act provided.

These provisions are difficult, and there is still not universal agreement in British Columbia as to their meaning. The basic effect of them is this: the prescribed classes have a lien for amounts owing to them. The lien is a right available against the owner. But the owner is only liable for the amount by which he has not paid his contractor. So, in order to give the right to lien some content, the owner is directed to hold back 15 per cent of amounts due to the contractor. That 13 per cent must be retained for a certain period of time, so that if someone in the construction chain fails to pay the people he has employed in connection with the improvement, there is money in the hands of the owner to enable them to be paid, at least in part.

2. Who May Claim a Lien?

According to section 5 of the Act, the persons who may claim a lien are "a workman, materialman, contractor, or subcontractor." Each of these expressions is then defined in section 2 of the Act. Problems have arisen in connection with one or two particular classes of persons who render services or supply materials in connection with an improvement.

(a) The subcontractor

Section 2 of the Act defines a subcontractor in these terms:

> "subcontractor" means a person not contracting or employed directly by an owner or his agent to do work upon or to place or furnish material, or to do both, on or for the making of an improvement but one who contracts with or is employed by the contractor or under him by another subcontractor or their agents for the purposes aforesaid, but does not include a workman;

Apart from its rather convoluted structure, this definition has two defects. Firstly, by defining a subcontractor as a person who does not contract directly with the owner, the provision fails to recognize the fact that in many construction projects the owner himself performs the function normally ascribed to the prime contractor. In such a situation, the effect of the above definition is to turn people who are normally contractors into contractors simply because there happens to be privity of contract between the owner and the person who usually occupies the position of a subcontractor.

There are several consequences under the present law of this transformation in the position of the subcontractor: the holdback is no longer assessed as a proportion of the total value of the improvement, but as a proportion of the value of the work done under individual contracts with transformed subcontractors and

suppliers of the owners;[4] the time for filing liens by the transformed subcontractor is changed from 31 days after substantial completion of the improvement to 31 days after substantial performance of the particular contract.[5] Although the time for the filing of liens by a materialman would seem to be unaffected by the transformation of the subcontractor (*see* section 23 (2)), the Court of Appeal has recently held, affirming Steward C.C.J., that a materialman must file a lien within 31 days after completion of the contract of the transformed subcontractor, and not merely within 31 days after completion of the improvement;[6] and although a transformed subcontractor would seem to suffer a loss in priority under section 40 of the Act, Fraser C.C.J. in *The Calla Bros. Cement Contractors Ltd.* v. *Coronation Credit Corporation Ltd.*,[7] held that he did not do so, but continued to enjoy the priority of a subcontract.

Some of these discrepancies would be cured by the contained in this Report concerning the separate holdback system and the time for the filing of liens and the release of holdbacks. The equation of the subcontractor with the contractor for the purposes of priority in determining rights to the lien funds would not however be rectified by any other recommendation. The Commission can see no reason why a person who in the normal case, is a subcontractor, should suffer a loss in priority because the owner employs no separate person as general contractor.

The Commission recommends:

The definition of a subcontractor should be amended to ensure that a person normally in the position of a subcontractor be treated as such for the purposes of determining priority amongst competing lien claimants.

The second defect in the definition of a subcontractor contained in section 2 of the Act is that it appears to include materialmen as well as people who are normally thought of in the industry as being subcontractors. The essential difference between a subcontractor and a materialman, as these terms are understood in the industry, is that a subcontractor undertakes to perform a task

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4. This is because the holdback is required to be retained in respect of contracts under or by virtue of which a lien may arise (*see* s. 21(1)). Where the owner has entered into one such contract with a general contractor, there is one large holdback; where he has entered into several individual contracts, there are several individual holdbacks. *See Alcock, Downing and Wright Ltd.* v. *ABA Plumbing and Heating Contractors Ltd.* (1972), 23 D.L.R. (3d) 728 (Co. Ct. of Westminster; affirmed by the Court of Appeal whose decision is not yet reported).

5. According to s. 23(1), the time for filing a lien is "not later than thirty-one days after the contract of the contractor has been completed, abandoned, or otherwise determined." This is the period applicable to both contractors and subcontractors and in the normal case it means the 31 days after substantial completion of the improvement. But this is not so where there are several "contract[s] of the contractor" being completed at different times.

6. *Alcock, Downing and Wright Ltd.* v. *ABA Plumbing and Heating Contractors Ltd. (supra).* There is another possible interpretation of the view of the Court of Appeal and that of Stewart, C.C.J. It is that the effect of expiry of 40 days after completion of the contract between owner-contractor and transformed subcontractor is that the owner-contractor may thereafter discharge the lien by payment of the 15 per cent holdback, but if it is not paid and remains in the owner-contractor's hands, the lien claimant may still recover it in a lien action providing he files within 31 days after completion of the improvement. The effect of this view is that between 40 days after completion of the particular contract and 31 days after completion of the improvement, the 15 per cent holdback is in a position analogous to the 85 per cent of the contract price at the time a lien is validly filed i.e. if it is in fact held back it is subject to a lien but if it has been paid out *bona fide* it discharges the lien *pro tanto*. This latter view seems more consistent with section 21(4) than the view expressed in the text.

7. Westminster County Court Registry No. 1775/63 (unreported).

involving the use of labour on the site, whereas a materialman does not.[8] The definition of subcontractor in section 2 however includes a person who contracts "to place or furnish material ... on or for the making of an improvement," whether or not he also agrees "to do work upon ... or for the making of an improvement." This is peculiar, since the Act also contains a definition of a materialman and numerous provisions which refer to subcontractors and materialmen as though they meant different things.

The Commission has not discovered any difficulties that have arisen in practice as a result of this problem of definition. The point should be cleared up however, since it is pointless to have definitions which fail to make clear who or what is intended to be caught by the definition, and the matter might become an important one if our recommendations concerning the progressive release of holdbacks are accepted.

The Commission recommends:

The definition of a subcontractor be altered so as to make clear that materialmen are excluded from the definition.

(b) Persons who hire out equipment for use in connection with an improvement

It has been held[9] that a person who supplies equipment together with men to operate it is a subcontractor within the meaning of the Act, but that a person who simply hires out equipment is not a subcontractor and cannot claim a lien.

It is difficult to see the reason for this distinction. In technical terms it can be explained by the fact that a person who is employed to do work on the site, using equipment which he owns, can be regarded as a subcontractor because he contracts "to do work upon ... an improvement," whereas if no operator is supplied, it would be artificial to describe the person who contracts to hire out equipment in these terms.

From the point of view of policy, there is little basis for the difference in treatment of rented equipment with an operator and rented equipment without an operator. The nature of the contribution to the improvement made by a person who hires out equipment is not dependent on whether he supplies an operator with the equipment and his ability to claim a lien should not dcpcnd on that question.[10] It is also more consistent with the generally understood distinction between materialmen and subcontractors that equipment renters should be treated as subcontractors rather than materialmen.

The Commission recommends:

The definition of a subcontractor be extended to cover persons who hire out equipment for use in connection with an improvement on land.

The following is a suggested draft of the definition of subcontractor which would incorporate all three recommendations made above.

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8. The special case of the supplier of equipment with an operator is dealt with *infra* at p. 52.

9. *Northcoast Forest Products Ltd.* v. *Eakins Construction Ltd.* (1960), 35 W.W.R. 233, 26 D.L.R. (2d) 251 (B.C.S.C.).

10. The *Ontario* and *Alberta Acts* contain provisions allowing persons who hire out equipment to claim a lien. *See The Mechanics' Lien Act, 1968-69*, S.O. 1968-69, c. 65, s. 5(5) and *The Builders' Lien Act*, R.S.A. 1970, c. 35, s. 4(4).

"Subcontractor" means a person, other than a workman, who

(a) contracts with or is employed by the contractor or under him by another subcontractor or an agent of a contractor or subcontractor to do work upon an improvement or both to do work upon an improvement and to place or furnish material for the making of an improvement; or

(b) rents equipment, with or without an operator, for use in the making of an improvement; and a person may be a subcontractor within the meaning of this definition even though he contracts directly with the owner, if the work normally undertaken by a contractor is being undertaken by the owner, and in such a case the person shall not be treated as a contractor.

(c) The architect

There has been litigation in several provinces on the question whether an architect is entitled to claim a lien in respect of amounts by which he is unpaid. In the recent case of *Re Computime Canada Ltd.*[11] it was held that an architect was entitled to claim a lien. In other cases in British Columbia a different conclusion has been reached. The Commission believes that the services an architect provides by way of supervision of an improvement should result in the architect's being able to file a lien. In the working paper, the Commission drew a distinction between the services which an architect provides by way of supervision and these which he provides by way of the drawing of plans. We suggested that an architect should be able to claim a lien for moneys owed in respect of the former but not the latter. The Commission received several submissions arguing that this distinction could not be supported. On further reflection, the Commission agrees with these critics of our original suggestion. It is hard to see how an architect's services in the form of supervision are any more of a contribution to the improvement than are his services in the form of the drawing of plans. No doubt the provision of supervisory services is closer in time to the actual construction than is the drawing of plans, but this is an artificial basis for distinguishing the two. When once the logic of including supervisory services is perceived, it is hard to resist its extension to other forms of an architect's work in connection with an improvement.

The provision should include engineers who render professional services of a type similar in nature to these of architects.

The Commission recommends:

Architects and engineers should be included within the range of persons able to claim a lien and the definition of the services for which they are entitled to claim should include all work done in connection with an improvement, whether or not the work was done prior to the commencement of construction.

3. Against Whom May a Lien Be Claimed and For What Amount?

Assuming that a valid lien exists, against whom can the lien holder claim? According to section 5, the person who contributes to an improvement has a lien "upon the interest of the owner in the improvement, upon the improvement itself, upon the material delivered to or placed upon the land upon which the improvement is situate, and upon the said land."

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11. (1971), 18 D.L.R. (3d) 127 (B.C.S.C.).

According to section 21(2)1 "a lien is a charge upon the amount directed to be retained by this section in favour of claimants whose liens are derived under persons to whom the moneys so required to be retained are respectively payable, or whose liens are filed as in this Act provided."

When set side by side, these provisions appear somewhat bizarre. They seem either to be contradictory, or else to create not one lien, but two. Section 5 says there is a lien on the land and then section 21 goes on to define a lien as being a charge on a particular fund. Perhaps the best way of looking at the provisions is to say that they create two liens, but in a special sense. The lien holder has a charge on holdbacks, which operates as a statutory security for amounts due but unpaid to the lien-holder. The intention of the provision appears to be that if the lien holder recovers "the amount directed to be retained" i.e. the holdback, he has recovered everything to which he is entitled under the Act and he has no further right. But then as security for the holdback, and in case he fails to obtain payment of it, the lien holder is given a further security, viz., a lien on the land and improvement. In other words, the holdback is a security for amounts owing to lien claimants, and the land and improvement are a security for the holdback.

These key provisions give rise to several problems and require more detailed consideration.

(a) The holdback system and the present law

The persons directed to retain a holdback are, according to section 21(1), "the owner or person primarily liable upon any contract under or by virtue of which a lien may arise." A difficult problem created by this wording is to know who is required to retain a holdback. There is no doubt about the owner. But is the contractor required to retain a holdback from his subcontractors and materialmen? Is the subcontractor required to retain a holdback from his sub-subcontractors and materialmen? And if each party in the construction chain is required to retain a separate holdback, how does this affect the amount the lien claimants are entitled to recover?

There is a surprising lack of conclusive authority on these questions, but they raise a matter of the most fundamental importance in connection with the holdback system. Before entering upon a consideration of whether separate holdbacks must be retained, the significance of the question must first be outlined. As explained above, the holdback system has two functions. It requires the owner to maintain a fund to meet the claims of lien holders. But at the same time it limits the owner's liability by declaring that the fund shall be maintained out of money otherwise payable to the contractor, and by providing that the owner's liability shall be limited to that sum, as long as he complies with the requirements of the Act. Thus, the holdback system has the combined effect of facilitating the exercise of the lien holder's right and limiting the owner's liability.

In considering the question whether the contractor is required to retain a holdback, it is the limitation of liability aspect of the holdback that is in issue. The question is whether, for example, a person who claims directly under a particular subcontractor is restricted in his claim against the owner to an amount equal to that held back by the contractor on the particular subcontract, or whether the claim is available against the whole 15 per cent in the hands of the owner. An example might conduce to clarity.

Suppose that an owner of land enters into a contract with a contractor, in

which the contractor agrees for $100,000 to erect a building. The contractor then enters into two subcontracts with Sl and S2, each for $40,000. Sl then enters into a sub-subcontract with SS for $20,000. To simplify the example, we may ignore the fact that the owner will probably make payments from time to time to the contractor, who in turn will make payments from time to time to Sl and S2 and so on, and imagine that the owner is going to pay to the contractor in one lump sum all the money which it is proper for him to pay. Under section 21(l), the owner is required to retain 15 per cent of the contract price for 40 days after the completion of the contract. The owner accordingly pays $85,000 to the contractor. The contractor now wishes to pay his subcontractors, Sl and S2. Is the contractor obliged to retain a holdback, or should he pay over the full $40,000 to each of Sl and S2?

In practice, there are reasons why the contractor will want to retain the holdback, independently of whether he is required in law to do so, and these will be examined shortly. But for the moment, suppose that the contractor decides that he is required in law to retain a holdback of 15 per cent, and he does so. He will, therefore, now pay $34,000 to each of Sl and S2 and will retain a holdback of $6,000 from each of them. Assume now that Sl pays to his sub-subcontractor, SS, only $5,000 out of the $20,000 owed to SS. SS files a lien against the owner's land. The amount of the claim is $15,000, i.e. the amount still owed by Sl to SS. How much is SS entitled to recover in his lien action?

The possibilities are as follows:

(1) He is entitled to recover the full $15,000, since this is the amount of the holdback in the hands of the owner, all of which is available to a single lien claimant regardless of his position in the construction chain.

(2) He is entitled to recover $12,000 on the ground that the amount of his claim is limited to the amount of the holdback in the hands of the contractor.

(3) He is entitled to recover $6,000 on the ground that he can only recover an amount equal to the sum owing to the person with whom the lien claimant contracted. In this third case, the amount owing to the person with whom the lien claimant contracted is $6,000, that being the amount owing by the contractor to Sl.

The leading authority on this point in British Columbia is *Denston Co. Ltd.* v. *Board of Trustees School District No. 37 (Delta)*.[12] In that case the Court of Appeal held that a materialman who had supplied materials to a subcontractor was not limited in his recovery to moneys held back by the contractor from the subcontractor who employed[13] the lien claimant, but was able to claim an amount up to a maximum of the full 15 per cent holdback retained by the owner. O'Halloran, J.A., giving the judgment of the Court, cited the following passage from the judgment of the County Court below

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12. (1958), 27 W.W.R. 141; 13 D.L.R. (2d) 494, (B.C.C.A.). Not all the facts of that case appear from the judgment of the Court of Appeal and the judgment of the trial judge is not reported. The facts on which the appeal was decided have, however, been recently stated by Stewart, C.C.J. in *Alcock, Downing and Wright Ltd.* v. *ABA Plumbing and Heating Contractors Ltd., supra*.

13. Throughout this section the word "employed" denotes not only a contract of service, but any contract under which materials are supplied or work is done in connection with in improvement.

and expressed his agreement with it:

> I am inclined to hold that the 15 per cent holdback to be retained by the owner or person primarily liable as set forth in section 21 ... means fifteen per cent of the whole or general contract price ...

On the basis of this decision, it has become settled practice in British Columbia for lien claimants to recover, to the extent that they are unpaid, against the full amount of the holdback in the owner's hands, regardless of the claimant's position in the construction chain; and settlements are invariably worked out on that footing. In addition, in the recent case of *Alcock, Downing and Wright Ltd.* v. *ABA Plumbing and Heating Contractors Ltd.*,[14] Stewart C.C.J., in commenting on the *Denston* case, said:[15]

> The issue in that case seems to have been whether the lien claimed by the plaintiff could be discharged by the contractor in carrying out the provisions of section 21 with respect to his contract with the subcontractor under or by virtue of which subcontract the plaintiff's lien directly arose. Although, in my opinion, the section could be interpreted in such a manner, the *Denston* case has clearly settled that such an interpretation would be contrary to the purpose of the Statute to give security to the various categories of lien claimants. The *Denston* case simply means to me that all lien claimants all the way down the line, whether their liens arise under subcontracts or under the general contract must have a claim to the fund created by holdbacks from the general contractor by an owner.

It is apparent from these authorities that, of the three possible methods of determining SS's entitlement in the example discussed above, the first represents the present position of the law.

(b) _The consequences of the present law

Because of the general practice in British Columbia, based on the view that the law allows a particular lien claimant to claim against the whole of the holdback fund in the hands of the owner, many contractors follow a practice of retaining substantial holdbacks from their subcontractors. If, in the example given above, the sub-subcontractor can claim the full $15,000 in the hands of the owner, the contractor will seek to protect himself against that situation. Under section 6 of the Act, the owner's liability is limited to the amount payable to the contractor. The owner has retained $15,000 from the contractor, and since that is the limit of his liability to the contractor, that is also the limit of his liability to the lien claimants. But if the owner pays the $15,000 to lien claimants, it is not now available for payment to the contractor.

Most contracts between owner and contractor require the contractor to indemnify the owner against the consequences of any lien claims. The position of the contractor is therefore hazardous. Any money paid out by the owner to lien claimants will be deducted from the holdback which otherwise would ultimately have been payable to the contractor, and a solvent contractor will be under a duty to discharge liens on behalf of the owner, either out of his own assets or out of holdbacks which he has retained. In order to protect himself, the contractor will wish to retain holdbacks from his subcontractors. At the very least, he will want to retain $15,000 since this is the amount which the owner may have to pay out

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14. *Supra*

15. At p. 740

to lien claimants. But $15,000 may not be enough to save the contractor from a substantial loss.

In the example, the contractor has two subcontractors. The second of these two, S2, may have performed his contract quite properly and may now therefore claim to be paid the amount which was retained by way of holdback. The contractor will not be able to resist this claim. Thus, the only way the contractor can adequately protect himself against the consequences of liens arising under the subcontract with Sl is to hold back $15,000 from Sl. But the contract between the contractor and Sl was for $40,000 only. If the contractor retains $15,000 of this sum, that represents 37 ½ per cent of that subcontract price. If there were four subcontracts each of $40,000 and a general contract price of $200,000, the owner's holdback would be $30,000. In these circumstances the contractor would have to retain $30,000 from each of his subcontractors in order adequately to protect himself. This would amount to 75 per cent of each of the subcontract prices.

The effect of allowing the materialman or sub-subcontractor to claim against the owner for the whole 15 per cent in the owner's hands exposes the contractor to considerable risk. Any money paid out by the owner to a lien claimant is money which otherwise would have been payable to the contractor. If the contractor has held back nothing at all, and the 15 per cent in the hands of the owner is entirely disbursed in satisfying lien claimants, the loss falls entirely upon the contractor.

Many contractors hold back substantial sums from their subcontractors in order to avoid placing themselves in a position of such great exposure to risk. This in turn slows down the flow of funds, thereby causing difficulties for the people who are kept out of large portions of their money for substantial periods of time, creating frictions which may impede the smooth course of the construction project and possibly even contributing to the likelihood that someone will file a lien. The effect of exposure to such inordinate risk is to force the contractor to seek to protect himself in case liens are filed. The only way he can do this is by keeping as much money in his hands as possible instead of letting it flow down the construction chain. But his act of protecting himself in this way renders more likely the very thing he is trying to avoid viz. the filing of liens.

It will be apparent that the effect of the *Denston* case is that there is only one holdback, viz. that of the owner. If the contractor and subcontractors retain 15 per cent from the people they employ, this does not relieve them from additional liability. The money they in fact hold back may go some way towards mitigating their exposure to risk if liens are filed, but it does not, under the present law, serve to limit their liability in the sense in which the owner's holdback marks the limit of his liability.

To summarize the above discussion, the position under British Columbia law is that the contractor and subcontractors enjoy no limitation on their exposure to risk by retaining a holdback since the only limit on the lien claimants' recovery is the 15 per cent holdback in the owner's hands. The general contractor is liable to the owner to meet the cost of clearing liens. Even if the contractor holds back 15 per cent or more from his subcontractors; he will be contractually liable for most of this sum to these subcontractors who have properly completed their subcontracts. Only a notional portion will therefore be earmarked for a group of lien claimants who claim under one subcontractor. The only limit on the amount recoverable by such a group of lien claimants, however, is the figure of 15 per cent of the prime contract price. The contractor will therefore often hold back a large percentage of the sum he owes to his subcontractors in an attempt to protect

himself, should liens be filed. The effect of this is to slow down the flow of funds along the construction chain.

(c) Reforming the present law

The main burden of the concern expressed by members of the construction industry was aimed at amending the Act in such a way as to remove the pressure which it exerts in slowing down the flow of funds along the construction chain. We will have more to say about the problem of the flow of funds in a later section of this Report,[16] but we believe that an important part of any attempt to improve the flow of funds along the construction chain must be to place a well-defined limit on the degree of exposure to risk of the contractor and subcontractor. The Commission proposes that the contractor and subcontractor should be required to retain a holdback of 15 per cent of the value of the work done by each of the people they employ and this holdback should mark the limit of the contractor's and subcontractors' exposure to risk at the hands of lien claimants who claim under persons so employed.

The Commission believes that such a provision would relieve some of the pressure which the Act presently exerts on the contractor and subcontractor to hold back large sums of money. The principle would be that every party in the construction chain, who engages another party to do work in connection with the improvement, would retain a holdback from that other party. This holdback would be designed to meet, at least in part, the lien claims of all persons the other party employs and it would mark the maximum amount recoverable by these claimants.

Although the principle is simple, the situation to which it applies is complex and clarity might again be served by referring to the example previously given in order to show how the recommended system would work. Thus, on a $100,000 contract, the owner should hold back $15,000 from the contractor. The contractor has two subcontracts, with S1 and S2, each for $40,000. He should hold back 15 per cent ($6,000) from each of them and pay over $34,000. S1 has a sub-subcontract with SS for $20,000 and he should hold back 15 per cent ($3,000) and pay over $17,000. If one of the subcontractors, S1, is unpaid and brings a lien action against the owner, the fund available for payment of the subcontractor is the sum owed by the owner to the contractor, provided this sum is not less than 15 per cent of the prime contract price. If the owner has not retained 15 per cent from the contractor, he must make the holdback up to 15 per cent from his own pocket. If the owner has retained more than 15 per cent from the contractor, the additional sum retained as well as the 15 per cent is available to subcontractors who claim a lien.

The operative principle is that, at the subcontractor level, the lien claimants (the subcontractors) may share, as a maximum, whichever is the greater of the sum still owing to, or the owner's statutory holdback from, the person (contractor) who employed the lien claimants. At the level of the subcontractors' lien claims, and provided there are no liens filed below that level, this scheme produces the same result as the present law.

If, however, it is SS, the sub-subcontractor who claims a lien, the proposed new scheme would bring about a major change. Under the present law, the only limit on SS's right to recover the full amount owed to him is the $15,000 limit of

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16. *Infra* at 133

the owner's holdback. This is in accordance with the decision in the *Denston* case.[17] Under the proposed scheme the lien claimant (sub-subcontractor) may recover a maximum of the sum owing (contractor's holdback) to the person (subcontractor) who employed the lien claimant. This would be 15 per cent ($6,000) of the contract price of the subcontract under which the lien claimant claims ($40,000), or more if more than 15 per cent has been held back by the contractor.

Similarly, if there were an unpaid supplier of the sub-subcontractor who claimed a lien, he could, to the extent that he was unpaid, recover the amount owed by the subcontractor to the sub-subcontractor, always provided that the potential liability of the subcontractor cannot fall below 15 per cent of the sub-subcontract price (the statutory holdback applicable at this level.) It will thus be seen that the proposed scheme assesses the amount recoverable by a lien claimant by reference to the sum to be held back from the person who employed the lien claimant, or by reference to the sum actually held back if it exceeds the statutory requirement.

The statutes in force in several of the other provinces already contain a provision which ensures this result. The Ontario Statute states:[18]

> Save as herein otherwise provided, where the lien is claimed by a person other than the contractor, the amount that may be claimed in respect thereof is limited to the amount owing to the contractor or subcontractor or other person for whom the work has been done or the materials were placed or furnished.

The *Ontario Act* also provides that the holdback shall not fall below 15 per cent. Similar provisions occur in the Acts in force in Manitoba, Saskatchewan, Prince Edward Island and Nova Scotia. When the holdback provision was first introduced into British Columbia in 1956, however, no such limitation on the exposure to risk of the contractor and subcontractor was included.

The situation in Alberta is also of some interest. Prior to 1960, the *Alberta Act* contained a provision similar to the one being discussed. It limited the amount of the lien claim to amounts owing to the contractor or subcontractor for whom the work was performed. In 1960, the *Alberta Act* was amended and the new section (section 6(2)) read:[19]

> Except as herein provided, where a lien is claimed by any person other than the contractor, it does not attach do as to make the owner liable for a greater sum than the amount owing to the contractor for whom, or for whose subcontractor, the work has been done or the material has been furnished.

What did this new provision mean? Could a subsubcontractor claim a lien up to the amount of the total holdback in the owner's hands, or was he restricted to the amount owing to the subcontractor with whom he contracted? In *C. J. Oliver Ltd.* v. *Foothills Lighting & Electric Ltd.*,[20]

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17. *Supra*

18. The *Mechanics' Lien Act, 1968-69*, S.O. 1968-69, c. 65, s. 10.

19. There is a virtually identical provision in the *New Brunswick Act*. *See Mechanics' Lien Act*, R.S.N.B. 1952, c. 142, s. 3(3).

20. (1966), 54 W.W.R. 37.

the Alberta Court of Appeal were divided on the question. The majority (per McDermid J.A.; Smith C.J.A., Cairns and Porter J.J.A. concurring), reversing the trial judge, thought that a sub-subcontractor could enforce his lien only up to the amount the contractor should have held back from the subcontractor who had employed the sub-subcontractor. The dissentient, Johnston J.A., thought that the amendment introduced into the *Alberta Act*, "does not restrict the lien of persons who did work for or supplied materials to the subcontractor."

The Buchanan Report[21] then took up the question. In unambiguously strong language, Chief Judge Buchanan called for the reversal of the decision of the majority of the Court of Appeal, and his recommendation was carried out in the new *Alberta Act* which followed the learned Judge's Report. Accordingly, the position in Alberta today appears to be that a single claimant, no matter what his position in the construction chain, may enforce his lien up to the full amount of the holdback in the hands of the owner. But the story does not end there. In a learned article in a recent issue of the Alberta Law Review,[22] Mr. W.H. Hurlburt, Q.C., pointed to the difficulties that would flow from this amendment to the *Alberta Act*. The author thought that the effect of the amendment was to place "a solvent prime contractor in a very difficult, if not impossible position." He also suggested that the only effective way for the contractor to protect himself from the consequences of the amendment was either not to pay any money to his subcontractors at all, i.e. to retain a holdback of 100 per cent, or to insist on a performance bond being given by each subcontractor.[23]

The Buchanan Report failed to address itself to the problem of the flow of funds along the construction chain and in its concern to reverse what was probably a bad interpretation of the actual wording of the *Alberta Act*, it appears to have produced a problem identical to the one which this Commission is now trying to solve.

The Commission recommends:

A provision similar in terms to section 10 of The Mechanics' Lien Act 1968-69*, S.O. c. 65, be added to the* British Columbia Act. *It provides:*

> Save as herein otherwise provided, where the lien is claimed by any person other than the contractor, the amount that may be claimed in respect thereof is limited to the amount owing to the contractor or subcontractor or other person for whom the work has been done or the materials were placed or furnished.

(d) The machinery of the holdback system

The Commission believes that the result of enactment of the previous recommendation would be that in the great majority of cases, the obligation of a

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21. *See* pp. 57 and 58.

22. (1971) 9 Alberta Law Review 407.

23. The holdback provisions of the *Alberta Act* were recently considered by Riley, J. in *Re Yale Development Corp. Ltd.* v. *A.L.H. Construction Ltd.* (1972), 22 D.L.R. 597 (Alta. S.C.). The effect of that decision is that where an owner employs no general contractor, but engages several subcontractors directly (who therefore occupy the position of contractors), there are different lien funds for each subcontractor and a lien-claimant can only recover the sum held back from the person under whom he claims. It is difficult to see how such a result could be reached under the *Alberta Act* if there were a general contractor.

person, under whom a lien arose, to discharge that lien, could be carried out without the person having to pay more than the amount of his holdback. Thus, in the ordinary case where several suppliers of a particular subcontractor file liens, the contractor's obligation to discharge the liens will require him to make available the holdback he has retained from the particular subcontractor. As long as that holdback is at least equal to 15 per cent of the value of the work done and materials supplied in connection with the subcontract, the amount of the holdback establishes the limit of the contractor's exposure to risk.

The effect of the recommendation would be the creation of what may be called a separate holdback scheme. According to this scheme, the holdback retained by any particular party in the construction chain is intended to discharge the lien claims of the person next but one below the party retaining the holdback. Putting it the other way round, a lien claimant is entitled to recover, as a maximum, the sum owed to the person who employed the lien claimant. Thus the holdback retained by the owner is intended to meet the lien claims of sub-subcontractors and a subcontractor's suppliers; the holdback retained by a subcontractor is intended to meet the lien claims of the sub-subcontractor's suppliers and, if there are any, the sub-sub-subcontractors; and so on.

In some cases, however, circumstances could arise in which the previous recommendation would fail to accomplish the result we are seeking to achieve, so that a person retaining a holdback of 15 per cent of the value of the work done might find that it was insufficient in amount to relieve him from further exposure to risk as a result of liens being filed.

The situations in which this might be rare and will require a peculiar concatenation of circumstances. They are also relatively complicated situations involving more than one insolvency in the same construction chain. We have, therefore, relegated discussion of matters to an Appendix,[24] and in the body of the Report, we confine ourselves to making a general recommendation indicating the principle which should apply in these complicated situations. That principle is that a party who retains a holdback equal in amount to 15 per cent of the value of the work done or materials supplied should be in a position, without having to pay more than the amount of his holdback, to remove all liens arising under the person from whom the holdback was retained.

The Commission recommends:

The amount necessary to discharge all liens arising under a person from whom a holdback was retained should not exceed the amount of the holdback, provided it is equal at least to 15 per cent of the value of the work done and materials supplied in connection with the contract between the person who retained a holdback and the person engaged by that person.

The circumstances in which additional machinery would be necessary, together with a suggestion as to the form that machinery might take, in order for the above recommendation to be implemented, are set out in Appendix A.

(e) Protecting the lien claimants

The Commission has recommended[25] that there should be separate holdbacks, i.e., that the contractor and subcontractor should retain a holdback as well as the

24. *See* Appendix A, *infra* at p. 238.

25. *Supra*, at p. 67

owner and it should define the maximum amount that may be recovered in a lien action by people who claim under the subcontractor.

Whilst this recommendation is an attempt to aid the flow of funds along the construction chain and to make the position of a head contractor more tolerable, it must be admitted that it will in many cases reduce the amount recoverable by lien claimants. In the working paper, the Commission therefore outlined ways in which it might be possible to redress the balance by adding to the protection available to the lien claimants.

Apart from the idea of fixing the amount of the holdback in the hands of the contractor and subcontractor at 15 per cent - the same amount as the holdback in the hands of the owner - the Commission suggested two ways in which the sub-subcontractors and materialmen might receive additional protection. The first of these was to increase the amount of the holdback in the hands of the contractor and subcontractor to 20 per cent. The second was to increase all holdbacks - the owner's, the contractor's, and the subcontractors' - 20 per cent on contracts below a certain figure, but to leave them at 15 per cent on contracts above that figure.

The former suggestion has not found favour with any of the other provinces; the latter is the system used in Manitoba and New Brunswick. In these provinces, the basic holdback provision requires the retention of 20 per cent of the value of the work and materials, but this figure drops to 15 per cent in the case of contracts where the value exceeds $15,000. There is also a provision that where the value exceeds $15,000, the minimum amount of the holdback shall be 20 per cent of $15,000 in order to avoid a situation in which the amount of the holdback on a contract for $14,500 exceeds the amount of the holdback on a contract for $15,500.

The Commission has decided to reject these two alternative ways of restoring to the sub-subcontractor and materialman some of the protection they are likely to lose by the introduction of a progressive holdback system. The Commission feels on reflection that they are inconsistent with the policy of the previous recommendation viz. aiding the flow of funds along the construction chain, and that the best approach to this problem is to recognize quite frankly that however one tries to tinker with the holdback, the more money that is required to be held back, the more the flow of funds is likely to be inhibited. Ultimately, a choice must be made between building in protection for the lien claimants at the expense of slowing down the flow of funds, or assisting the flow of funds at the expense of a measure of protection to the lien claimants. In the light of the logic of representations from members of the construction industry that concentration should be placed on improving the flow of funds, the Commission has decided to make no recommendation in favour of the 20 per cent holdback in any of the situations described above. Accordingly, the figure of 15 per cent mentioned in the previous recommendations in connection with the separate holdback system should be retained as a measure of the amount of the separate holdbacks.

Later in this Report,[26] we return to the problem of the flow of funds. This will be in connection with a proposed new provision in the Act which is designed to operate as an alternative to the lien and holdback system.

(f) The owner's rights against lien claimants

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26. *Infra*, at p. 133

Where the contractor fails to complete his contract with the owner, and the latter is forced to go elsewhere to have it completed, the owner will normally deduct from the amount he pays the original contractor the amount it will cost to have the building completed. This procedure is in line with the general result that an action in damages against the contractor would bring, and will enable the owner to use the money to employ another contractor in order to complete the contract. What happens to the holdback in this situation? Can the owner use sums which he retained by way of holdback from the first contractor in order to complete the building by employing a second contractor? The short answer is, no. Section 21(6) provides:

> Where a contractor or subcontractor makes default in completing his contract or subcontract, the percentage required to be retained under this section shall not, as against any claimant who by virtue of sub-section (2) has a charge thereon, be applied by the owner, contractor, or subcontractor to the completion of the contract, subcontract, or for any other purpose, or for the payment of damages for the non-completion of the contract or subcontract by the contractor or any subcontractor, nor in payment or satisfaction of any claims against the contractor or any subcontractor.

It may be, however, that the owner has in fact retained more than the 15 per cent holdback that he was required to retain under section 21(1). If he has, the surplus is also available to lien claimants since the limit on the owner's liability imposed by section 6 is only directed at protecting the owner from having to pay out a sum in excess of what he owes to the contractor. Hence, any money still owing to the contractor is available to meet lien claims.

The owner will generally have a contractual right to deduct from what he pays to the contractor the cost of completing the building. If, for example, the contractor has done work to the value of $100,000, and has been paid only $60,000 at which point the contractor abandons the contract, the owner will have a contractual right to complete the building out of moneys which would have been payable to the contractor if he had completed the building. Part of the $40,000 representing the work already done may therefore be used to complete the building. It is clear that of the $40,000 representing the difference between the value of the work done and the amount so far paid to the contractor, $15,000 may not be used to complete the building if there are lien claims of that amount or more. But if the subcontractors claim liens for $40,000, what happens to the amount in excess of $15,000 in the owner's hands? Can he still use it to complete the building if the additional costs of completion would absorb it, or must it be paid to the subcontractors in satisfaction of their lien?

The most widely held view appears to be that the owner may set off against any money retained in excess of 15 per cent of the value of the work done, the cost of completion of the improvement, or damages for faulty workmanship or delay.[27]

The Commission agrees with this position, and in pursuance of the policy of clearing up ambiguities in the Act, feels that a provision should be inserted in the Act to make clear that section 21(6) applies only to the 15 per cent holdback and not to additional sums that are in fact retained. This will enable the owner to set

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27. *See* Macklem and Bristow, *Mechanics' Lien in Canada*, p. 90. There have been several decisions concerning the true construction of the *Ontario Act* on this point. For the most recent, *see Canadian Comstock Co. Ltd.* v. *Toronto Transit Commission* [1970] S.C.R. 205; (1970), 8 D.L.R. (3d) 582 and *S. I. Guttman Ltd.* v. *James D. Mokry Ltd.* (1969) 1 D.L.R. (3d) 253; [1969] 1 O.R. 7.

off such additional sums against the cost of completion of the project.

The Commission recommends:

Section 21(6) be amended so as to apply only to the 15 per cent holdback and not to additional sums that are in fact retained.

(g) Close connection between owner and contractor

In some cases, where there exists close connection between the owner and the contractor, a suspicion may be created that they have fixed the contract price at an unrealistically low level in order to reduce the amount of the holdback and hence the amount available to lien claimants. Such a practice appears to be encouraged by the fact that the formula for calculating the amount of the holdback, contained in section 21(1), takes the contract price as the basis of calculation.

The Commission believes that a change should be made in the formula for calculating the amount of the holdback by making it clear that the contract price shall not be treated as conclusive evidence of the value of the work done.[28]

The Commission recommends:

Section 21(1) should be amended so as to provide that where there is evidence to suggest that the contract price is abnormally low having regard to the amount of work agreed to be done, and it appears that the owner and contractor did not deal at arm's length, the holdback shall be calculated on the basis of the actual value of the work done; and evidence of the actual value of the work done may be adduced for this purpose.

(h) Payment to lien claimants

Where a contractor pays a subcontractor or supplier in respect of work done on a particular job out of contract moneys made available by the owner, there is no requirement under the present law that the payment be appropriated to the debt owed to the subcontractor or supplier in respect of the work done on the job in question. The general rules of appropriation of payments to debts apply, according to which the debtor may appropriate the payment, or if he fails to do so, the creditor may do so. The result of this is that the creditor is able to appropriate moneys paid on one job to debts owing on another job. In this way, he can preserve the full amount of the debts due on the job where the time for filing liens has not expired, whilst appropriating the payment to debts due on a job where the time for filing liens has expired.

The contractor could prevent this happening if he made an appropriation of the debt to the job in question, but if he fails to do this, it is not the contractor who suffers, but the other lien claimants on the job in respect of which the moneys were paid. The right of the creditor to make the appropriation himself gives him a right to bring an additional slice of the total amount owing to him within the protection provided by the Act, and the consequence of doing so is to diminish the protection given to the other lien claimants. We believe that this is an undesirable situation. The failure of the payor to make the proper

28. There is some indication in the present wording of section 21(1) that the contract price was not intended to be conclusive as the basis for determining the value of the work done, but the form of words chosen is somewhat equivocal. Section 21(1) says "the value [of the work, etc.] shall be calculated upon evidence given in that regard on the basis of the contract price."

appropriation should not be a source of additional loss to lien claimants.

The Commission recommends:

Where no appropriation of moneys paid by the payor to the payee in connection with an improvement is made (whether it be contractor to subcontractor and materialman, or subcontractor to sub-subcontractor and materialman, or sub-subcontractor to materialman), the moneys paid shall be deemed to be appropriated to the debt due to the payee in connection with the improvement in respect of which the moneys became available; and in any proceedings brought under the Act, any party should be entitled to adduce evidence to the effect that a particular payment received by a lien claimant was in fact a payment of money in connection with the improvement in respect of which the lien claimant claims a lien.

(i) The purchaser of land subject to an unregistered lien

The Commission received two submissions pointing out a difficulty which had not been considered in the working paper. If an owner of land employs people to offset an improvement on his land, and before the people so employed have been paid, but within the period for filing liens, the owner sells the land to a purchaser, can the persons who effected the improvement claim liens against the purchaser?

Mr. D.M. Gordon, Q.C., drew the Commission's attention to the decision in *Carr & Son and Carr Plumbing & Heating Ltd.* v. *Hayward and Bell*[29] in which Archibald, C.C.J. held that in the above described situation, the lien is available against the purdhaser and if it is registered before expiry of the filing period it may be enforced against the purchaser even though it was not registered at the time of the sale.

Mr. Gordon pointed out that a different view has been taken in some other provinces. He added:

> In defence of the British Columbia view, it can ... be argued that when a purchaser buys an improved property on which work has been completed only within 31 days before, it will be seldom that the purchaser had no knowledge of the recent work, and he ought to make inquiry as to whether it had been paid for, which he could easily do. It is less anomalous that he should be put to that trouble than that contractors, who have not exceeded their statutory time limit for filing, can be defeated by a quick sale after completion of the work.
>
> Though provinces that hold sale defeats a lien make an exception where the buyer has 'actual notice,' that is a poor protection for contractors. A buyer could easily be in a position where all the probabilities were that the work was not paid for in full, yet he would have no 'actual notice.'

The Commission agrees with Mr. Gordon's reasoning.

The Commission recommends:

A lien registered within the time limited for the registration of liens shall he enforceable against a purchaser of the land subject to the lien, even though it was not registered at the time the purchaser obtained title to the land; and the Act and the Land Registry Act*, P.S.B.C. 1960, c. 208, s. 38(1)(9) should be amended to make absolutely clear that this is so. The reference in section 38(1) to mechanics' liens should be taken out of clause (g) and a new clause added to section 38(1) which provides that any mechanics' lien registered within the time for the registration of liens under the* Mechanics' Lien Act *shall be valid against the registered owner of the land, whether or not he was the registered owner at the time the right to a lien arose.*

4. The Time for Filing Liens and the Release of Holdbacks

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29. (1955-56), 17 W.W.R. 399 (Co. Ct. B.C.).

(a) Generally

The last section was concerned with the situation where liens are filed and claimants seek payment from the holdback. But in the majority of cases this does not occur, and all that happens is that when the job is completed and a certain period has expired, the holdbacks are released and paid to the persons to whom contract moneys are due. The effect, in the meantime, of the owner or other person retaining a holdback is to restrict the flow of finance down the construction chain. Until the holdback is released, the various people who contribute services and materials remain *pro tanto* unpaid. In order for the holdback to be an effective method of maintaining a fund for lien claimants, it is clear that the holdback has to be retained for a sufficiently lengthy period of time to give the lien claimants an opportunity to realize that they are not going to get paid by the person who employed them. On the other hand, if the holdbacks are tied up for lengthy periods of time, the people ultimately entitled to payment when the holdbacks are released may suffer as a result of being kept out of their money for too long.

The time for which a holdback must be retained is contained in section 21(1). It provides that the holdback shall be retained, "for a period of forty days after the contract has been completed, abandoned or otherwise determined." Section 21(4) then provides:

> Payment of the percentage required to be retained under this section may be validly made so as to discharge all liens after the expiration of the said period of forty days mentioned in subsection (1), unless in the meantime a claim of lien has been filed or proceedings have been commenced to enforce any claim of lien or charge against the said percentage ...

The effect of these provisions is that, unless liens have been filed or proceedings commenced, the holdback may be released after the expiry of 40 days from the discharge or abandonment of the contract. It seems clear that the 40 days that must expire in order for the holdbacks to be released, run from the completion of the main contract and not from the completion of a particular contract between, for example, a subcontractor and the contractor. This means, according to the Act, that holdbacks cannot be released until 40 days after the completion, or abandonment of the project.[30]

This construction of the section dealing with the time at which holdbacks may be released is reinforced by the wording of section 23 of the Act. Section 23 deals with the limitation period for the filing of liens. The holdback is designed to establish a fund out of which lien claimants may be paid. It is therefore unlikely that an owner would he permitted to release holdbacks at a time during which the period for filing liens had not yet expired.[31] Consequently, it is a reasonable construction of the section dealing with the time for releasing holdbacks that they were not intended to be released while it was still possible for a lien claimant to file a lien. It is therefore worth comparing the time for the release of holdbacks with the time for the filing of liens.

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30. The situation is different, however, where there is no general contractor.

31. This seems to have been the idea underlying the decision of Stewart, C.C.J. and the Court of Appeal in Alcock, *Downing and Wright Ltd.* v. *ABA Plumbing and Heating Contractors Ltd., supra*, chap. VI, note 6.

Section 23(1) deals with the limitation period for the filing of liens by contractors and subcontractors. It provides:

> A claim of lien of a contractor or subcontractor may be filed as in this Act provided at any time after the contract or subcontract has been made, but not later than thirty-one days after the contract of the contractor has been completed, abandoned or otherwise determined.

The expression "contract of the contractor" means the head contract between the owner and the contractor. The time for the release of holdbacks to the contractor and to subcontractors was not therefore intended to start running until the completion of the head contract. The reason for the discrepancy of nine days between the time at which the right to file a lien lapses and the time at which holdbacks may be released is explained by the need to give the person who has retained the holdback an opportunity to ensure that 31 days had clearly expired, and to avoid disputes about a day or two, and then, before the owner releases the holdback, to give him a chance to check that no liens have been filed.

Materialmen are dealt with in section 23(2). The materialman may file a lien "not later than thirty-one days after the improvement for which the material has been supplied has been completed or abandoned, or the contract for the construction or making of the improvement otherwise determined." Like section 23(1), this provision contemplates that the 31 days begin to run not from the time of discharge of the contract by which the lien claimant is employed, but from the time at which the whole improvement is completed or abandoned.

The limitation period for the filing of liens in respect of the other class of potential lien claimants, workmen, is dealt with in section 23(3). Here, the limitation period of 31 days begins to run in some cases from the time at which the particular contract is complete. in the ordinary case, a workman may not file a lien "later than thirty-one days after the last work has been done by him for which the lien is claimed." Here the principle is clearly completion of the particular contract by which the workman was employed, i.e., the contract of employment, and not completion of the project. But then an exception is introduced, based on the principle qf completion of the improvement rather than completion of the particular contract. Section 23(3) goes on to provide:

> ... but no workman shall be held to have ceased work on an improvement until the completion of the same if he has in the meantime been employed upon any other work by the same contractor.

It is apparent that the general principle embodied in the Act in relation to the time for the filing of liens and the release of holdbacks is that time runs from the completion of the improvement. Employees are treated differently, Although their situation is also subject to an exception in favour of completion of the improvement.

The distinction between the time of completion of the improvement on the one hand, and completion of the particular contract on the other hand, is of significance mainly in large projects which span a considerable period of time. When a materialman or subcontractor is employed in the early stages of such a project, he may have completed his task long before the completion of the project as a whole. This is particularly so in the case of subcontractors who are working exclusively on the excavation and preparation of the site and who will have completed their subcontract before the construction itself is begun. It is also true of many materialmen who may have supplied all they have contracted to supply

a considerable time before completion of the improvement. Nonetheless, holdbacks retained by the owner from the contractor, which notionally represent money owing to the subcontractors and suppliers, cannot safely be released to the contractor until 40 days after the improvement is completed. In practice, the contractor will generally, though not always, pay them; and many suppliers refuse to contract on the basis that 15 per cent of the sum owing to them will be retained for the statutory period after completion of the improvement. The situation is such that either some subcontractors and suppliers are kept out of their money for unduly long periods of time or the head contractor has to finance these subcontractors and suppliers to the extent of 15 per cent of their several contract prices.

In the working paper the Commission expressed the view that it would be desirable to alter this situation, but refrained from making any tentative recommendation. The working paper contained two suggestions as to possible ways of meeting the problem. They were:

(1) Limit the amount of the holdback to a maximum sum, so that the person who has completed the work but who cannot recover the holdback for a substantial period is prejudiced to a lesser extent than under the present law; or

(2) Provide that holdbacks may be released and lien rights expire at a time measured from the completion of the particular contract, without the necessity for completion of the entire project.

The first of these to solutions does not appear to have been adopted in any province in Canada. The second solution has been adopted in Alberta, Manitoba, Ontario, and New Brunswick. In essence the statutes in these provinces provide that the 40-day period for releasing holdbacks and the 31-day period for filing liens, or the equivalent period in the particular province, begins to run from the time at which a certificate of completion of a particular subcontract has been given. After the expiry of 40 days from the giving of the certificate, the holdback may be reduced by 15 per cent of the specific subcontract price. There are then further provisions which stipulate that the main provision is not to apply if liens are filed before the reduction in the holdback is made.

Under the *Ontario* and *Alberta Acts*, if a certificate of completion of a contract or subcontract is not issued when it ought to be, the court may make an order declaring that the contract or subcontract has been completed, and such an order has the same effect as the issue of a certificate of completion. Under the *Alberta Act*, where the contract is not being supervised by an architect or engineer, a subcontractor or a contractor may apply to the court for an order that the contract has been completed.

The Commission pointed out in the working paper that if this second solution were to be adopted, it would only go a small way towards meeting the problem, since on a large construction project most of the subcontractors and materialmen will be engaged on the construction for the whole, or substantially the whole, duration of the project, so that they would not be affected by a provision that the 31 days for the filing of liens was to run from the completion of their particular contract rather than completion of the project as a whole.

The Commission has come to the conclusion that there are certain advantages in the scheme in force in Alberta, Manitoba, Ontario, and New Brunswick. The

most recent and most sophisticated of these schemes is the Alborta one and we have taken it as the most useful source for fashioning a provision for this Province.

At the same time, it should be mentioned that some difficulties were pointed out to the Commission in connection with a proposal to release holdbacks from time to time as and when the contracts of subtrades were substantially performed. Most of these objections to the scheme were voiced at the meeting of the British Columbia Commercial Law Subsection of the Canadian Bar Association.

The first objection was that if the time at which liens could be filed and holdbacks released varied from person to person; depending on the date on which their particular contract was completed, it might be difficult to say in the case of a particular subcontractor at what time his right to file a lien started to run and some lien claimants might be caught out because they assumed that they had more time within which to file than was in fact the case. It was pointed out that the present law at least had the advantage of simplicity and a fair degree of certainty in its operation since most lien claimants have to file at the same time as one another. The Alberta scheme, as well as the others mentioned above, provides that the time for filing begins to run as soon as the particular subcontract, under which lien claimants were employed, has been certified by the design authority as completed. This means that if a subcontractor obtains materials from several materialmen, their filing times also expire at the same time as that of the subcontractor. Furthermore, a subcontract in respect of which a certificate of completion causes time to start running is confined to a subcontract made directly under the prime contract. If there are subsubcontractors and materialmen who supplied them, the filing time of the latter will still depend on the date at which a certificate of completion is given in respect of the subcontract entered into directly under the prime contract, even though there is not even privity of contract between these materialmen and the subcontractor.

The second objection to the Alberta scheme for the release of holdbacks was that it might force a subcontractor or a supplier into a difficult decision as to whether to file a lien when the time of expiry of his right to do so was drawing close. The subcontractor would have only thirtyone days from the time at which he completed his contract to make up his mind whether to jeopardize his good relations with the contractor or whether to sacrifice his right to a lien.

The Commission believes that an answer may be found to both of these problems by extending beyond the normal thirty-one day period, the time at which liens must be filed where the event which causes time to run is completion of a subcontract rather than completion of the improvement. Sixty day and ninety day credit terms are quite usual in the construction industry for supply contracts and if the filing period were extended to take account of this fact, the materialman would not have to beware of his lien expiring within the period for which he is prepared to give credit, and the subcontractor is also entitled to expect that after ninety days the contractor should have paid him. He is not therefore obliged to make a decision to file a lien within a time which, having regard to common payment practice, is rather short.

The Commission's proposal is, therefore, that the period within which liens must be filed following a certificate of completion of a subcontract should be ninety-three days after the date of that certificate, with a correspondingly adjusted period for the release of holdbacks. We believe, however, that there is merit in retaining the principle that the latest time at which liens may be filed is thirty-one

days from completion or abandonment of the improvement. To extend the filing time to ninety-three days once the improvement is completed or the financial outcome of the venture is already apparent would be unnecessary. A lien claimant should therefore be able to file a lien within whichever is the earlier of ninety-three days from the certificate of completion in respect of the subcontract under which the lien claimant was employed or thirty-one days after substantial completion of the improvement.

A third difficulty raised in connection with the scheme for releasing holdbacks from time to time was that the holdback in the hands of the owner would gradually be eaton away as particular subcontracts were completed, so that if the contractor abandoned the job after half of the work had been done, leaving a number of unpaid lien claimants, the subcontractors who had already completed their work, and sub-subcontractors and suppliers they employed, would have been paid in full to the detriment of lien claimants who were not fortunate enough to have completed their work before the contractor's act of abandonment.

There is some truth in this objection but it must not be exaggerated. The number or proportion of subtrades who are likely to find they can take advantage of the scheme at an early stage will be small. Generally the only major subtrades who will have completed their work within the first half of a project will be the excavators and their suppliers, and the effect of an early release of the holdback from the owner to enable them to be paid will he relatively small. The conclusion at which the Commission has arrived is that this disadvantage is not so significant as to outweigh the merits of the scheme.

The Commission has formed the view that the balance of advantage lies in the adoption of a scheme providing for the early filing of lions and release of holdbacks in appropriate circumstances. There is no doubt that such a scheme would be a complicating factor in terms of the time for filing liens and the release of holdbacks. We believe however that for the few subcontractors and persons employed by them who will be able to take advantage of the scheme, this will be a price worth paying.

In fairness to our adviser, Mr. B.D. Macdonald, the Commission would like to say that Mr. Macdonald expressed his disagreement with a scheme providing that there be any special time periods for situations in which work in connection with a particular subcontract was completed prior to completion of the improvement as a whole. He felt that the result of having the time within which liens must be filed and holdbacks released altered in some cases from the general rule of thirty-one and forty days, respectively, after completion of the improvement, would introduce more complexity into the law than could be justified by the advantages that would be gained.

The Commission recommends:

1. *The incorporation into the law of this Province of a provision similar to section 16 of* The Builders' Lien Act*, R.S.A. 1970, c. 35, with the amendment that the operative period for the filing of liens should be ninety-three days and for the release of holdbacks it should be one hundred days.*

2. *The Act should provide that, notwithstanding recommendation (i), the latest time at which liens may be filed should be thirty-one days after completion or abandonment of the improvement.*

In order to incorporate section 16 of the *Alberta Act* into the law of this Province, certain changes in the arrangement and organization of the provisions will be

necessary.

Section 16 of the *Alberta Act* is set out in full in the form in which it appears in that Act:

> 16. (1) In this section, "supervisor" means an architect, engineer or other person upon whose certificates payments are to be made under a contract:
>
> (2) Where a contract is under the supervision of a supervisor and a period of 35 days has elapsed after a certificate issued by the supervisor to the effect that the sub-contract has been completed has been given to the subcontractor by a sub-contract made directly under that contract, the amount to be retained by the person primarily liable upon that contract shall be reduced
>
> (a) by 15 per cent of the sub-contract price, or
>
> (b) if there is not specific sub-contract price, by 15 per cent of the actual value of the work done and materials furnished under that sub-contract,
>
> but this subsection does not operate if and so long as any lien derived under that sub-contract is preserved by anything done under this Act.
>
> (3) The contractor or sub-contractor may at any time after the completion of the contract demand a certificate of completion of the contract from the supervisor, which demand shall be made in writing and may be delivered to the supervisor or sent to him by registered mail with postage fully prepaid and a copy of the demand shall be given to the owner or his agent, or sent to the owner or his agent, as the case may be, by registered mail with postage fully prepaid.
>
> (4) The supervisor of whom the demand is made shall within 10 days of the making of the demand issue and deliver to the applicant the required certificate of completion and if the supervisor neglects or refuses to issue or deliver the certificate of completion within the 10 days limited for so doing, the court.
>
> (a) upon the application of the contractor or a sub-contractor, and
>
> (b) upon being satisfied that the contract has been completed,
>
> may make an order that the contract has been completed upon such terms and conditions as to costs or otherwise as seem just, and the order has the same force and effect as a certificate of completion issued by the supervisor would have.
>
> (5) Where a certificate issued by a supervisor to the effect that a sub-contract by which a sub-contractor became a sub-contractor has been completed has been given to that sub-contractor, then for the purposes of section 30, subsections (1), (2) (3) and (4) that sub-contract and any work done or to be done thereunder and any materials furnished or to be furnished thereunder shall, so far as concerns any lien thereunder of that subcontractor, be deemed to have been completed, done or furnished not later than the time at which the certificate was so given.
>
> (6) Where a contract is not under the supervision of a supervisor, the court,
>
> (a) upon the application of the contractor or a subcontractor, and

(b) upon being satisfied that the contract has been completed,

May make an order that the contract has been completed upon such terms and conditions as to costs or otherwise as seem just, and the order has the same force and effect as a certificate of completion issued by a supervisor would have.

Implementation of this provision is likely to prove a little complicated, since the provision has to be integrated into the very difficult sections of the Act (sections 21 and 23) dealing with holdbacks, their release and the time for filing liens. In addition, account must be taken of the special problems which arise when there is no general contractor and since litigation seems to be occurring quite frequently because of the failure of the Act to provide for this situation, we feel it is one which can no longer be ignored. We have therefore sought to indicate the main provisions that will have to be contained in sections 21 and 23 in relation to the time for filing and the release of holdbacks.

The time for the filing of liens is presently dealt with in section 23. We should make clear that the position of workmen is not intended to be affected by these provisions. The employment relationship is very different from a trading relationship and the factors of long-term business relationships, usual credit terms and lengthy holdbacks are irrelevant to the employment context. We are dealing here therefore with the filing times applicable to a contractor, subcontractor, sub-subcontractor and materialman.

The principles applicable to filing times should be as follows:

Where there is a general contractor

(1) the general contractor and a materialman employed by him may file a lien not later than thirty-one days after the general contract has been completed, abandoned or otherwise determined;

(2) a subcontractor (which includes a subsubcontractor and sub-subsubcontractor etc.) or a materialman employed by or under a subcontractor may file a lien not later than the earlier of the following two times

(a) ninety-three days after the issue of a certificate of completion of the subcontract by the design authority or, if the design authority fails to issue such a certificate or if there is no design authority, ninety-three days after an order of the court that the subcontract has been completed,

(b) thirty-one days after the general contract has been completed, abandoned or otherwise determined.

Where there is no general contractor

(1) a materialman not employed by or under a subcontractor may file a lien not later than thirty-one days after completion or abandonment of the improvement;

(2) a subcontractor, or a materialman employed by or under a subcontractor, may file a lien not later than the earlier of the

following two times -

(a) 93 days after the issue of a certificate of completion of the sub-contract by the design authority, or, if the design authority fails to issue such a certificate or if there is no design authority, 93 days after an order of the Court that the subcontract has been completed;

(b) 31 days after the improvement has been completed or abandoned.

In the above suggestion relating to filing times where there is no general contractor, "subcontractor" is used to mean a person who would be a subcontractor if there were a general contractor.

The principles applicable to the time for releasing holdbacks should be as follows:

Where there is a general contractor

(1) notwithstanding (2) and (3) below, all holdbacks may he released 40 days after the general contract has been completed, abandoned or otherwise determined;

(2) where a certificate of completion of a subcontract has been issued by the design authority, the owner may release to the contractor 15 per cent of the value of the work done under that subcontract one hundred days after issue of the certificate of completion; and the contractor, subcontractor or any other party who may have retained a hcldback in connection with the subcontract which is certifies to be completed may at a like time release any such holdback;

(3) where there is no design authority or the design authority fails to issue a certificate of completion in respect of a subcontract, the owner may release to the contractor 15 per cent of the value of the work done under the subcontract one hundred days after an order of the court that the subcontract has been completed; and the contractor, subcontractor or any other party who may have retained a holdback in connection with the subcontract in respect of which such an order has been issued may at a like time release any such holdback.

Where there is no general contractor

(1) notwithstanding (ii) and (iii) below, all holdbacks may be released 40 days after the improvement has been completed, abandoned or otherwise determined;

(2) where a certificate of completion of a subcontract is issued by the design authority, the owner may release to the subcontractor 15 per cent of the value of the work done under that subcontract one hundred days after issue of the certificate of completion; and the subcontractor or any other party who may have retained a holdback in connection with the subcontract which is certified to be completed may at a like time release any such holdback;

(3) where there is no design authority or the design authority fails to issue a certificate of completion in respect of a subcontract, the owner may release to the subcontractor 15 per cent of the value of the work done under the subcontract one hundred days after an order of the court that the subcontract has been completed; and the subcontractor or any other party who may have retained a holdback in connection with the subcontract which is certified to be completed may at a like time release any such holdback.

In the above suggestion relating to the time at which holdbacks may be released where there is no general contractor, subcontractor is again used to mean a person who would be a subcontractor if there were a general contractor.

These suggestions for engrafting section 16 of the *Alberta Act* on to the law of this province may appear formidable, but this is only because they recognize a complexity which the present law ignores viz. the absence of a general contractor. The most obvious example of the difficulty created under the present law where there is no general contractor occurs in the apparent conflict between section 21 and section 23(2). The difficulty is that under section 21(1) and (4), the owner may release the holdback retained from a particular subcontractor (who is, for most purposes, treated as a contractor under the Act) 40 days after completion of that subcontractor's contract and thereby discharge liens arising under that subcontract. A materialman employed by that subcontractor may however register a lien against the owner's title up to 31 days after completion of the improvement. It is quite impossible to give effect to both of these provisions.[32] We believe our suggestions as to the mode of implementation of section 16 of the *Alberta Act* will overcome such problems.

The Commission does not normally undertake the responsibility for the drafting of statutes designed to implement its recommendations, but we feel in relation to sections 21 and 23 of the Act that the problems they create are so intricate and the measures we propose relatively complex that we bear some responsibility for demonstrating that the package is capable of being parcelled in a form which appears to be intelligible and workable. The following is therefore a suggested draft of sections 21 and 23 and it takes into account the amendments we suggest, in relation to the time of release of holdbacks and the filing of liens and it also contains consequential alterations in accordance with our recommendations that there be separate holdbacks.

21. (1) Notwithstanding section 6 and section the owner, contractor, subcontractor or other person primarily liable upon any contract under or by virtue of which a lien may arise shall retain a holdback for a period of time known as the holdback period;

(2) The holdback shall be retained for the holdback period irrespective of whether any contract to which subsection (1) applies provides for partial payments or payment on completion of the work;

(3) The holdback is an amount equal to fifteen per cent of the value of the work, service and materials actually done, placed or furnished, as

32. The position at the moment in this situation is that the provisions of section 21 relating to the release of holdbacks prevail over the provisions of section 23(2) relating to the time for filing liens. *See* Alcock, *Downing and Wright Ltd.* v. *ABA Plumbing and Heating Contractors Ltd.*, *supra*, chap. VI, note 6. Assuming that where there is no general contractor, the holdbacks retained from each subcontractor are separate holdbacks, this is a logical result. Nonetheless, it may be a trap for materialmen unfamiliar with the oddities of the Act as it applies to the situation where there is no general contractor.

described in section 5, in performance of a contract under or by virtue of which a lien may arise;

(4) The value of the work, service and materials referred to in subsection (3) shall be calculated upon evidence given in that regard on the basis of the contract price; but where there is no specific contract price, or where there is evidence to suggest that the contract price is abnormally low having regard to the amount of work agreed to be done and it appears that the owner and the contractor did not deal at arm's length, the holdback shall be calculated on the basis of the actual value of the work, service and materials and evidence of the actual value may be adduced for this purpose.[33]

(5) A lien is a charge upon a holdback required to be retained by subsection (1) such that each holdback is charged with payment of all persons employed by or under the person from whom the holdback was retained;

(6) All payments up to eighty-five per cent of the value of work, services and materials calculated in accordance with subsections (3) and (4) made in good faith by a person required to retain a holdback to a person entitled to file a claim of lien shall discharge *pro tanto* any such lien;

(7) Payment of a holdback required to be retained by subsection (1), (including the holdback retained by an owner from a contractor or, if there is no contractor, from a subcontractor in respect of a subcontract falling within section 21Y(2))[34] may be made after expiry of the holdback period and all liens and charges of the person to whom the holdback is paid, or of any person employed by or under the person to whom the holdback is paid, are thereby discharged unless in the meantime a claim of lien has been filed or proceedings have been commenced to enforce any claim of lien or charge against the said holdback.[35]

It might be convenient as well as logical to begin a new section at this point, rather than overload section 21 with matters that raise related though different issues. To save confusion we refer to this new section as section 21X.

21X (1) In this section and in sections 21Y and 23 "supervisor" means an architect, engineer or other person upon whose certificate payments are to be made under a contract or subcontract;

(2) A subcontractor may at any time after the completion of his subcontract demand a certificate of completion of the subcontract from the supervisor, which demand shall be made in writing and may be delivered to the supervisor or sent to him by registered mail with postage fully prepaid and a copy of the demand shall be given to the owner or his agent, or sent to the owner or his agent by registered mail with postage fully prepaid;

(3) The supervisor to whom the demand is addressed shall within ten days' of the making of the demand, and if he is satisfied that the subcontract is completed, issue and deliver to the subcontractor a

33. *See* the recommendation on page 74 *supra*.

34. This is a reference to a new section for which we suggest a draft *infra*.

35. This subsection is the equivalent of the present section 21(4). The closing words of section 21(4) are omitted entirely since the point to which they relate is the subject of a separate recommendation in this Report. *See* page 124 *infra*.

certificate of completion of the subcontract;

(4) If the supervisor neglects or refuses to issue or deliver the certificate of completion within ten days or if there is no supervisor, the court may, upon application of the subcontractor and upon being satisfied that the subcontract has been completed, make an order that the subcontract has been completed upon such terms and conditions as to costs or otherwise as seem just, and the order has the same force and effect as a certificate of completion isshed by a supervisor would have.

Another new section would be useful at this stage to deal with the "holdback period" referred to in our suggested section 21(1). We refer to the new section as section 21Y.

21Y. (1) Where no certificate of completion has been issued by a supervisor, and where no order of the court has been made, to the effect that a subcontract has been completed,

(i) if the owner engaged a contractor, the holdback period is the forty days next after the contract between the contractor and the owner has been completed, abandoned or otherwise determined;

(ii) if the owner did not engage a contractor, the holdback period is the forty days next after the improvement has been completed or abandoned.

(2) Where a certificate of completion has been issued by a supervisor, or where an order of the court has been made, to the effect that a subcontract has been completed, the holdback period in relation to that subcontract and all work, service or materials actually done, placed or furnished in connection with it, is the one hundred days next after the issue of such certificate or order, unless the forty day period referred to in subsection (1) expires before the one hundred day period referred to in this subsection, in which case the forty day period referred to in subsection (1) is the holdback period notwithstanding the issue of a certificate or order of the court that the subcontract has been completed.

Turning now to section 23, which deals with the time within which liens may be filed, the essential requirement is to ensure that in all instances the filing times are in harness with the time specified for the release of holdbacks. This means that the structure and form of the provision dealing with the time for filing liens should reflect the structure and form of the provision dealing with the time for release of holdbacks. We suggest the following draft.

23. (1) Where no certificate of completion has been issued by a supervisor, and where no order of the court has been made, to the effect that a subcontract has been completed,

(a) if the owner engaged a contractor,

(i) a claim of lien of a contractor or subcontractor may be filed in the manner provided in this Act at any time after the contract or subcontract has been made, but not later than thirty-one days after the contract of the contractor has been completed, abandoned or otherwise determined;

(ii) a claim of lien for materials supplied may be filed in the manner provided in this Act at any time after the contract to supply the materials has been made, but not later than

thirty-one days after the contract of the contractor has been completed, abandoned or otherwise determined;

(b) if the owner did not engage a contractor,

(i) a claim of lien of a subcontractor may be filed in the manner provided in this Act at any time after the subcontract has been made but not later than thirty-one days after the improvement has been completed or abandoned;

(ii) a claim of lien for materials supplied may be filed in the manner provided in this Act at any time after the contract to supply the materials has been made, but not later than thirty-one days after the improvement has been completed or abandoned.

(2) Where a certificate of completion has been issued by a supervisor, or where an order of the court has been made, to the effect that a subcontract has been completed,

(a) a claim of lien of the subcontractor may be filed in the manner provided in this Act at any time after the subcontract has been made, but not later than ninety-three days after the issue of the certificate or order of the court;

(b) a claim of lien for materials supplied in connection with the subcontract may be filed in the manner provided in this Act at any time after the contract to supply the materials has been made, but not later than ninety-three days after the issue of the certificate or order of the court;

unless the thirty-one day period referred to in subsection (1) expires before the ninety-three day period referred to in this subsection, in which case the thirty-one day period shall replace the ninety-three day period notwithstanding the issue of a certificate or order of the court that the subcontract has been completed.

It will be observed that we have said nothing about mines and quarries, workmen or section 23(4) relating to the expiry of liens. We would suggest that immediately after section 23 might follow a new section dealing with mines and quarries, followed by a new section dealing with workmen. Section 23(4) should then be given a section of its own. The section dealing with mines and quarries is dealt with later in this Report rather than here since it raises a problem of a different nature from the matters considered here. The section dealing with workmen should provide:

A claim of lien of a workman may be filed in the manner provided in this Act at any time during the performance of the work, but not later than thirty--one days after the last work has been done by him for which the lien is claimed, except for a lien claimed in respect of a mine or quarry, when the time herein before mentioned shall be sixty days; but no workman shall be held to have ceased work on an improvement until the completion of the same if he has in the meantime been employed upon any other work by the same contractor or subcontractor.

Section 23(4), which should be assigned to a new section, should provide:

Every lien or charge in respect of which a claim of lien is not filed in the manner and within the time provided in this Act is extinguished.

If the draft sections we have suggested to replace the present sections 21 and 23 were adopted, some additional definitions might also prove helpful. The meaning of abandonment of an improvement is not altogether clear in some situations under the present law and it appears to contain an element of intention to abandon. The Commission believes that a more objective definition is called for. It would also be useful to define the date of issue of an architect's certificate of completion since the time for filing liens and releasing holdbacks may depend upon it.

1. Abandonment means the expiry of a period of 30 days during which no work has been done in connection with the contract or improvement, as the case may be, unless the cause for the cessation of work was and continued to be a strike, lockout, sickness, weather conditions, holidays, order of a court, a shortage of materials, or other such like cause; and abandoned has a corresponding meaning.

2. A certificate of completion of a subcontract issued by a supervisor is deemed to be issued on the date on which it is issued, providing the subcontractor and the owner both receive copies of the certificate within ten days of the date of issue; but if either the subcontractor or the owner does not receive a copy within the ten day period, the certificate is deemed to be issued on the later of the dates on which the subcontractor and the owner receive a copy of the certificate.

This still leaves sections 21(5) and (6) to be dealt with. Section 21(5) states:

> Every contract for an improvement now or hereafter made shall be read and construed as if amended so as to conform with this section.

The clear intention of this provision is that the parties shall not be able to contract out of the holdback provisions contained in section 21. Under our suggested draft of the new holdback provisions, some features of the holdback would no longer be contained in section 21 (*see* section 21Y *supra)* and in addition there is the case of mines and quarries for which a special holdback period is required. It might accordingly be appropriate to allocate a new section to the present section 21(5) stating

> The provisions of this Act relating to holdbacks apply to every contract in respect of which a lien is capable of arising under this Act notwithstanding any term to the contrary contained in such contract.

As to section 21(6), we have already recommended an amendment to make clear that holdbacks retained in excess of 15 per cent may be used to complete a contract if the cost of completion exceeds the balance of the contract price. This subsection in its amended form might also best be allocated to a new section.

(b) _Mines and quarries

In the case of materialmen and workmen employed on mining or quarrying contracts, the period within which liens must be filed is extended from 31 days to 60 days. Section 23(2) provides:

> A claim of lien ... in the case of a contract to supply materials in respect of a mine or quarry ... shall be filed not later than sixty days after the materials have

been supplied, placed, or furnished to the mine or quarry.

Section 23(3) which deals with workmen who do work on a mine or quarry, is to similar effect. The meaning of Section 23(2) as it relates to mines and quarries is that the 60 days within which liens must be filed begins to run not from the last delivery of materials, but from the time of delivery of the particular materials in respect of which a lien is claimed. This means that where a materialman supplies materials in connection with a mine or quarry over an extended period of time, if at the end of this time he has not yot been paid for materials he supplied earlier on, he may have lost the right to file a lien in respect of these materials supplied earlier on.

In the working paper, the Commission tentatively suggested that this provision should be amended to provide that the right to file a lien should not expire from time to time, but rather at a time measured by reference to completion of the contract. It has been pointed out to the Commission, however, that material and services supplied in connection with mining are in a different position from these supplied in respect of other forms of construction except with regard to particular buildings on the site. There is for the most part no one day of completion which will clearly mark the point at which the time for filing liens will begin to run. Where services and materials are supplied from time to time, perhaps on the basis of one underlying or prevenient agreement, with no definite point of completion in view, the Commission is persuaded that it would be impracticable to refer to the time of completion of the improvement as the moment from which the filing period begins to run.

The difficulty with the present law is that it requires liens to be filed within 60 days after the materials were supplied and this period may not be as long as the usual period of credit given by the supplier to the person he supplies. This may often result in the right to file a lien being lost before the supplier is alerted to the fact that he ought to exercise the right.

The Commission believes that the principle which ought to apply in the case of supplying materials in respect of a mine or quarry is that the 60 days should run from the time at which the last materials are supplied. This should be so whether or not the materials are supplied from time to time under separate contracts, or whether they are supplied on the basis of a single prevenient agreement. The choice here is one of deciding between maintaining a rule which results in relatively short periods for the filing of liens, or extending the period within which liens may be filed, but at the expense of tying up money in the form of holdbacks. In this case, we believe that balance of the agreement lies in favour of extending the period within which liens may be filed.

In the case of workmen, there is no need for any change, since the time within which they may file liens already runs from the time of the last work done.

The Commission recommends:

The Act should be amended so as to provide that in the case of the supply of materials in respect of a mine or quarry, a claim of lien may be filed not later than 60 days after the last materials have been supplied by the lien claimant to the mine or quarry, regardless of whether all, part or none of the materials were supplied pursuant to a prevenient agreement.

It has been drawn to the Commission's attention that there is a discrepancy between the time for filing liens and the time for the release of holdbacks in the case of mines and quarries. The time for filing liens has been extended to 60 days,

whereas the normal period is 31 days. This is no doubt because time begins to run from the moment at which services or materials are supplied, rather from the time of completion. But the time at which holdbacks may be released has not been correspondingly amended. It is still governed by section 21 (1) and hence is "forty days after the contract has been completed, abandoned or otherwise determined." Whilst the practice in the industry has adjusted to deal with this situation, the Act creates an anomaly which should be removed.

All that is required is an amendment to provide that holdbacks may not be released until a reasonable time after the expiry of the time for filing liens. The time for filing liens is sixty days after the materials have been supplied, placed or furnished to the mine or quarry; the time for releasing holdbacks should therefore be a further ten days thereafter.

The Commission recommends:

The holdback provisions of the Act should be amended so as to provide that a holdback in respect of the supply of materials, or in respect of work done by a workman, in connection with a mine or quarry shall be retained for a period of seventy days after the last materials have been supplied, placed or furnished to the mine or quarry or the last work done on the mine or quarry.

(c) The meaning of "completion of the contract"

Section 2, the definition section of the Act, states:

> "completed," whenever used with reference to any contract in respect of an improvement, means substantial performance, not necessarily total performance;

Section 23(2), which determines the time within which a materialmen must file a claim of lien, provides that such a lien shall be filed "not later than thirty-one days after the improvement to which the material has been supplied, has been completed or abandoned, or the contract for the construction or making of the improvement otherwise determined." It will be seen that strictly speaking, the time for filing, in the case of a materialman, runs not from the time of completion or abandonment of the main contract, but from the time of completion or abandonment of the improvement. The argument has been made that since, according to section 2, completion only means substantial completion when used with reference to a contract, the completion referred to in section 23(2), being completion of an improvement, means not substantial, but total completion. This argument was rejected by the Court of Appeal of this Province[36] in *Hasler Bros. Ltd.* v. *Phillips.*[37] But because of the ambiguous wording of the Act, the Commission feels that the definition of "completed" ought to be altered so as to make quite clear that it means both substantial completion of an improvement and substantial performance of a contract for an improvement.

The Commission recommends:

The definition of "completed" in section 2 of the Act be amended so as to make clear that it includes improvements as well as contracts in respect of improvements.

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36. (1962), 40 W.W.R. 445 (B.C.C.A.).

37. There would also be certain mechanical difficulties in view of the absence of certificates of title with regard to highways.

The *Ontario* and *Alberta Acts* both contain a definition of "completion" in terms similar to that in the *British Columbia Act*. But they go on to qualify the definition, both with an identical subsection. That subsection reads as follows:

> For the purposes of this Act, a contract shall be deemed to be substantially performed
>
> (a) when the work or a substantial part thereof is ready for use or is being used for the purpose intended, and
>
> (b) when the work to be done under the contract is capable of completion or correction at a cost of not more than
>
> (i) 3 per cent of the first $250,000 of the contract price,
>
> (ii) 2 per cent of the next $250,000 of the contract price, and
>
> (iii) 1 per cent of the balance of the contract price.
>
> For the purposes of this Act, where the work or a substantial part thereof is ready for use or is being used for the purpose intended and where the work cannot be completed expeditiously for reasons beyond the control of the contractor, the value of the work to be completed shall be deducted from the contract price in determining substantial performance.

In the working paper, the Commission indicated that it felt there would be some benefit to be derived from a more precise definition of substantial completion than the common law gives, and submissions received from members of the construction industry have also indicated they would like to see more precision in the definition.

The Commission recommends:

The adoption of the above quoted provision as a aefinition of substantial performance, with the addition of the words "or an improvement substantially complete" immediately before clause (a) in order to take account of the previous recommendation.

5. Highways

Section 4 of the Act provides:

> Nothing in this Act extends to a highway or to any improvement done or caused to be done thereon by a municipal corporation.

It is clear that one effect of this provision is that no lien attaches to highways. But does it also mean that the holdback provision does not apply? Read literally, it would have that effect. But the section has not been read literally, as will be seen in connection with the trust provision. The rationale for exempting highways from the lien provision is that the ultimate remedy for enforcement of a lien is sale of the property. The prospect of highways exchanging hands amongst private sellers and buyers has little to commend it.[38] But, as has been suggested above, the Act can be looked upon as creating not one lien but two, the first being a charge on a notional fund and the second a charge on land. There is no necessary reason why the undesirability of sales of highways should mean that the holdback provisions of section 21 ought not to apply; and there is no reason why workmen, materialmen, subcontractors and contractors should not have a lien on the

38. S. 30(2)

holdback fund. The only necessary provision, in order to avoid sales of highways, is that the section providing for a right of sale[39] should not apply to such property.

In the working paper the Commission made the tentative suggestion that holdbacks should be retained in respect of highways even hough there would be no right of sale. We felt that the holdback provisions could operate quite effectively in the case of highways in the absence of a right of sale, since the right of sale is only needed where the owner is insolvent and public authorities are seldom allowed to become insolvent.

On further reflection, we have decided that there is little to be gained by extending the statutory holdback scheme to highways. Public authorities generally require that the people they employ supply performance bonds and labour and material payment bonds and these give at least as much protection to claimants as the holdback system does. In addition, practices in connection with highway construction have become well settled and understood and we do not feel that the extension of the holdback provisions to highways would be of sufficient significance to justify the change. We therefore make no recommendation concerning highways and the holdback system. Later in this Report, however, we consider highways again in the context of the trust provision.[40]

6. The Cancellation and Discharge of Liens

The filing of a lien by one of the parties in the construction chain is a serious matter for the owner and the contractor. It is a sign that all is not as it should be with the project and it may cause the progress of the construction to be impeded. "Further, the people providing finance to the owner will want some kind of assurance or proof of the continued soundness of the venture before they are prepared to continue the disbursement of funds. According to section 7(2), "advances or payments made under a mortgage after a claim of lien has been filed shall rank after the lien." Consequently, in order to preserve his priority, the mortgagee will want the liens discharged and the title cleared before he will advance any more money.

The owner will now turn to the contractor. He wants to be assured that the project will continue to progress and since he needs more money from the mortgagee in order for that to happen, he will want to know why his head contractor has allowed liens to be filed, and what he proposes to do about getting rid of them. In addition, the contract between the owner and the contractor almost invariably provides that the contractor is liable to indemnify the owner against the cost of clearing the liens, and in any event the owner will generally be unwilling to advance any more funds to the contractor until the liens are discharged. When liens are filed, there is therefore likely to be considerable pressure to have them removed as quickly as possible.

It was also pointed out in the Buchanan Report that the extreme seriousness for the owner and contractor of liens being filed gives to potential lien claimants a ready opportunity to "blackmail" the contractor and owner.[41] The right to file

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39. *Infra*, P. 180

40. This aspect of the Act was discussed *supra*, in connection with the arguments in favour of repeal of the Act.

41. (1958), 26 W.W.R. 15; 13 D.L.R. (2d) 491 (B.C.C.A.).

a lien is a lethal weapon in the hands of an irresponsible subcontractor or materialman. It requires that the owner and contractor be given a reasonable defence against it in order to ensure that it is not used improperly to gain an advantage to which the lien claimant is not entitled.

These questions raise the problem of how to discharge or cancel a lien. There are several provisions in the Act dealing with discharge or cancellation of the liens. These will be considered in turn.

(a) The general cancellation provision: section 28

Section 28 provides:

> An owner may at any time apply to a Registrar or Mining Recorder to have a claim of lien cancelled where
>
> (a) a lien has absolutely ceased to exist under sections 26 and 27;
>
> (b) an action to enforce the claim of lien has been dismissed, and no appeal from such dismissal has been taken within the time limited for such appeal;
>
> (c) an action to enforce the claim of lien has been discontinued;
>
> (d) the claim of lien has been satisfied;
>
> and upon such application, and upon the Registrar or Mining Recorder being satisfied as to the facts, he may cancel the claim of lien accordingly.

Applications to cancel a lien under this provision are apparently rare, except where the lien has been paid or settled and a release obtained. Notwithstanding, the Commission indicated in the working paper that it might be desirable to provide in the Act what exactly an applicant for cancellation must do in order to have his lien cancelled. No submissions were received directly concerning this point and the Commission has therefore little in the way of direct information as to the problems that may occur under this section. This may be because of the infrequency with which applications are made, apart from cases where the lien has been paid or settled, or it may be because the provisions work well enough in practice. The Commission has therefore decided to make no recommendation in connection with section 28.

(b) Cancellation of lien by making payment or giving security: section 33(1)

According to section 33(1)

> Any person against whose property a claim of lien has been filed under this Act may apply to have the claim of lien cancelled upon payment of the claim, or sufficient security for the payment thereof being given.

This section provides a method of discharging the lien. But in order to discharge it the owner must either pay the lien claimants in full or give security for the full amount of the lien claim and costs. This may involve the owner in having to make available sums considerably in excess of his actual liability. According to section 5, a lien may be claimed for amounts owing to the lien claimant. These amounts may be very large, depending upon how much contract money has been misapplied by the person whose default has precipitated the filing of liens. The amounts claimed may be far in excess of the holdback. The owner's actual liability

on the other hand is, by section 6, limited to the amount of the holdback, plus any other sums owing to the contractor, but not yet paid. Now Although the owner's liability is limited, the amount of payment or security he has to give in order to discharge the lien is not so limited, since the latter amount is measured by the amount of the lien claim, not by the amount of the owner's liability. Thus, the owner, or the contractor on his behalf, is required, in order to take advantage of the cancellation of lien provision in section 33(1), to give security in an amount possibly very much larger than the amount for which he will ultimately be found liable.

The making of such a payment into court should not however affect the ultimate liability of the owner to a lien holder. The Commission believes that the object of section 33 was to ensure the reconciliation of two principles. First, that the owner should be given a right to have liens on his land cancelled without having to wait for the trial; and second, that such a cancellation should not prejudice the rights of the lien claimants. In order to satisfy these two principles, it is only necessary to ensure that there is sufficient money available to meet the maximum possible amount of the claims.

The Commission recommends:

For the removal of doubt, the Act should make clear that the giving of security to procure the cancellation of a lien does not deprive the owner of the protection given to him by section 6.

There is a further difficulty created by section 33. The person entitled under the section to give security or pay the lien claimants is "the owner against whose property a claim of lien has been filed." In many contracts, the contractor is bound to keep the property free and clear of all liens. Under the present wording of section 33, the contractor cannot avail himself of its provisions without obtaining authority from the owner and providing him with an indemnification of costs. This procedure is unnecessary.

The Commission recommends:

The contractor or any person liable on any contract in connection with the improvement be allowed to provide security.

(c) Discharge by payment into court of the holdback: section 21(4)

A third method of discharging a lien appears to be granted by section 21(4). This provides that the "percentage required to be retained," i.e., the holdback, may be paid out after expiry of the proper period, "unless in the meantime a claim of lien has been filed or proceedings have been commenced to enforce any claim of lien ..." If such a claim has been filed, or proceedings have been commenced,

> The owner or any person entitled may pay the percentage into Court with respect to the said proceedings or claim of lien, and the payment into Court constitutes a valid discharge to the owner with respect to the said liens.

This section appears to give the "owner or any person entitled" a right to pay into court the holdback and then to have the liens vacated. If the section had been construed so as to have that effect, the result would be that if an owner was confronted with lien claimants, he would have available a choice of methods for getting his title cleared, other than by actual payment. He could give security for the full amount of the lien claims under section 33, or he could pay into court the amount of the holdback. Where the lien claims were for less than the amount of the holdback, he would presumably choose the former; where they were more

than the amount of the holdback, he would choose the latter. While section 21(4) has not been construed so as to give the owner the right to clear his title by payment in of the amount of the holdback. in *Cross and Grant* v. *Brooks*[42] the Court of Appeal (per Sheppard J.A.) stated:

> While section 21(4) states that the payment shall constitute a "valid discharge" that discharge is not declared to be operative forthwith for the reason that the discharge is conditional upon the payment in complying with section 21(4) ... Whether the payment in does comply with section 21(4) is a triable issue and must be decided upon the trial of the action (S.30). The purpose of section 21(4) is not to provide the discharge forthwith but to provide the owner with a defence to the enforcement of the liens against the land and to provide the lien holders with a fund to be substituted for their security on the land.

As has been pointed out at the beginning of this section, it is essential to provide reasonable opportunities to the owner to have liens cancelled, providing the claims of the lien holders are not thereby prejudiced. Section 33 provides such an opportunity if the owner is willing to pay into court the amount of the lien claims. But this may be an unduly onerous burden to impose on the owner if the amount of the lien claims exceeds the amount of the holdback. The ultimate liability of the owner is limited to the amount of the holdback, and the question here is whether the mechanism for discharging the liens prior to trial of the action should be made to reflect this fact. The Commission believes that the owner should be allowed to have his title cleared prior to the trial if he is prepared to pay into court the amount of the holdback, together with any other sums still owing to the contractor.

Chief Judge Buchanan, in considering this problem, observed:[43]

> I think it is perfectly reasonable that if the owner pays into court the full amount for which he can be held liable under section 17 [the holdback section], then he ought to have no further liability and the rights of lien claimants ought to be restricted entirely to the moneys which he has so provided. So long as he has provided the proper amount then there is no reason why his land should continue to be encumbered or that he should continue to be under personal liability.

At the same time, the learned judge felt that there were certain dangers in vacating the lien in return for the payment into court. He therefore found that it was essential to ensure as far as possible that the proper amount of the holdback was accurately determined. If this were not done, the lien claimants would lose their charge on the land, and then it might turn out at the trial that the amount that should have been paid into court was higher than the amount actually paid in. Chief Judge Buchanan therefore recommended a procedure for payment into court of the amount of the holdback plus amounts owing to the contractor that would come as close as possible to eliminating the possibility of payment into court of an insufficient amount. His recommendation was adopted without amendment, but with some re-organization, by the Alberta Legislature as section 18 of the *Alberta Act.* That section provides:

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42. *See* the Buchanan Report at p, 80.

43. Unless the aggregate amount recoverable by the lien claimants exceeded the actual amount of the liens. In that case cancellation of the liens would have been achieved under section 33(1) on payment into court of the amount of the lien plus security for costs.

(1) Upon the expiration of the time limited by section 30, payment of the lien fund may be validly made so as to discharge every lien in respect thereof unless, in the meantime, a statement of lien has been registered.

(2) Where a statement of lien has been registered, the owner or a mortgagee authorized by the owner to disburse the moneys secured by a mortgage may,

(a) by interlocutory application in any proceedings that have been commenced to enforce a lien, or

(b) on application by originating notice of motion, pay into court the amount of the lien fund.

(3) An application under subsection (2), notice shall be given as provided in section 37, subsection (1).

(4) Payment into court ordered under subsection (2) discharges the owner from any liability in respect of liens and

(a) the money when paid into court stands in the place of the land, and

(b) the order shall provide that the liens be removed from the title to the land concerned.

(5) On an application under subsection (2), the court

(a) may hear and receive such evidence, by affidavit or viva voce or otherwise, as it considers neccessary in order to determine the proper amount of the lien fund to be paid into court,

(b) may direct the trial of an issue to determine the amount of the lien fund to be paid into court, and

(c) may refuse the application if it is of the opinion that the determination of the amount of the lien fund should be made at the trial of the action.

In order for this provision to be incorporated into the law of this Province, certain alterations in the drafting would be necessary. Thus, there is no equivalent of section 37(1) of the *Alberta Act* in the *British Columbia Act*. Section 37(1) provides that:

> The statement of claim shall be served upon all persons who by the records of the land titles officer appear to have an interest in the land in question and upon such other persons as the court may direct.

Section 30(1) of the *British Columbia Act* provides that:

> ... a claim of lien or liens for any amount may be enforced by action in the Court according to the practice and procedure of the Court ...

It would be sufficient to add the words "or an application made" before the words "according to the practice and procedure of the Court" to take account of this problem.

Another problem, partly one of drafting and partly one of substance, arises in connection with the use of the expression "lien fund" in subsections (2) and (5) of section 18 of the *Alberta Act*. The drafting problem arises because the various holdback provisions of the *Alberta Act* are drafted around the concept of a "lien fund" which is defined in section 15(1) of the Act as follows:

> In this section and in section 18, the expression "the lien fund" means the percentage retained by the owner as required by this section, plus any amount payable under the contract which has not been paid by the owner under the contract in good faith prior to the registration of a lien, less any amount permitted by section 16 [the release of holdback section] to be paid.

This is a useful technique for ease of reference to the holdback concept and might well be usefully adopted were it not for the problem of substance. The problem of substance is that the *Alberta Act* adopted the concept of a single holdback in the hands of the owner, rather than the separate holdback system which the Commission favours. The notion of a single lien fund defined according to the owner's holdback is not in harmony with the substantive structure of rights the Commission recommends and cannot be incorporated unaltered into the procedural devices available to the parties.

The principle which should apply in integrating the right of the owner to have liens discharged prior to the trial and the separate holdback system is that the owner should be able to have the liens removed if he, or someone else, pays into court the maximum amount available to the lien claimant or lien claimants. The recommendations on pages and of this Report, together with the suggestions in Appendix A, contain the criteria for determining how this amount is assessed. In substitution, therefore, for the reference in section 18 of the *Alberta Act* to "lien fund," the Commission would insert the expression "the aggregate amount which may be recovered by all lien claimants."

To this we would add a provision to take account of a further possibility. It may happen that two out of three suppliers of a single subcontractor file liens. If the owner discharges these liens by payment into Court of the aggregate amount recoverable by these lien claimants, there is the possibility that after the liens are discharged, the third supplier may file a lien. If this third lien claimant had filed a lien at the same time as the first two, the amount that would then have had to be paid into court to discharge the lien would be no more than would have been necessary to discharge the liens of the first two claimants.[44] If, therefore, only two of three possible lien claimants file liens in the first instance, but a third lien claimant files after the aggregate amount recoverable by lien claimants (including the third one) has already been paid into court, the owner should be able to apply to have the liens discharged without further payment into court. The effect of the act of filing by the third lien claimant will be in that case simply to establish his right to a share in the distribution of the available lien funds.

This additional provision which we propose would of course only apply where the lien claimant who filed after other liens had already been discharged was a member of a class which included in its membership someone whose lien had already been discharged by payment into court of the aggregate amount recoverable by the earlier batch of lien claimants. Unless this was the case, the part of the lien funds available to persons in the position of the later lien claimant would not yet have been paid into court.

By way of an exception to the owner's right to have the later lien claimant's lien discharged without further payment into court, where the later lien claimant alleges that the available lien funds are in fact larger than the amount at which they

44. By "a class of lien claimants" we mean all the lien claimants engaged by the same person. For a discussion of the meaning of "class" as the expression is used in the Act, *see* Appendix A.

were assessed in the application to discharge the earlier liens, the judge should receive evidence as to that allegation and make an appropriate determination.

It would be unnecessary to reproduce subsection (1) of section 18 of the *Alberta Act*, since there is already an equivalent provision in section 21(4) of the *British Columbia Act*.

Section 21(4), which deals with the discharge of liens by payment into court of the holdback, provides that, "the owner or any person entitled" may pay the holdback into court and have the liens discharged. No indication is given in the Act of what is meant by "person entitled," and no obvious meaning leaps to mind. Indeed, since the section purports to be designating who may make the payment in, to say that the "person entitled" may do so scarcely carries the matter any further.

A mechanics' lien action is nominally against the owner. But under the proposed separate holdback system, the particular funds out of which lien claimants will receive payment are in substance the moneys owing to the person who employed the lien claimant. Thus, if the lien claimant is a sub-subcontractor or a supplier of a subcontractor, it is the holdback, retained by the contractor from the subcontractor who employed the sub-subcontractor or supplier, plus any other sums owing to the subcontractor on that job in excess of the holdback, out of which payment will come.

The legal mechanics of the process are that the lien claimants obtain from the owner the sums properly recoverable under the lien claim, and the owner then deducts that sum from the holdback he has retained and pays over to the contractor only the balance of the holdback. The contractor now receives a depleted holdback, and the amount by which the holdback is depleted is equal to the amount which the contractor still owes the subcontractor, this being the amount the lien claimants have recovered out of the holdback in the hands of the owner. The contractor now simply retains the sum which he owed to the subcontractor, thereby putting himself in the same position as if the holdback had not been depleted. The net result is that the subcontractor has paid the lien claimants, a perfectly proper result since it was the subcontractor's failure to pay the people he employed that caused the liens to be filed.

For the purpose of obtaining a discharge of liens by payment into court under section 21(4), it would appear realistic, in the light of the above analysis, to provide expressly that the contractor should be permitted to make the payment into court and to have the liens discharged. The same reasoning applies, *mutatis mutandis*, to a subcontractor.

Subject to these modifications and additions, and to minor points of drafting, we believe that a provision similar to section 18 of the *Alberta Act* should be enacted in British Columbia.

The Commission recommends:

1. *The addition of a new section to the Act in the following terms:*

   (1) Where a claim of lien has been filed in accordance with section 24 of this Act, the owner, the contractor, a subcontractor or a mortgagee authorized by the owner to disburse the moneys secured by a mortgage may

(a) by interlocutory application in any proceedings that have been commenced to enforce a lien, or

(b) on application by originating notice of motion;

pay into court the aggregate amount which may be recovered by all lien claimants.

(2) Payment into court ordered under subsection (1) discharges the owner from any liability in respect of liens and

(a) the money paid into court stands in the place of the land, and

(b) the order shall provide that the liens be removed from the title to the land concerned.

(3) Where an application has been made in accordance with subsection (1) and the liens have been removed in accordance with subsection (2), if additional liens are then filed, application may be made in accordance with the procedure laid down in subsection (1) to have the additional liens removed in accordance with the provisions of subsection (2) on payment into court of whatever additional sum, if any, is necessary to bring the amount in court up to the aggregate amount recoverable by all lien claimants.

(4) On application under subsection (1) or (3), the court may

(a) hear and receive such evidence, by affidavit or viva voce or otherwise, as it considers necessary in order to determine the proper amount to be paid into court,

(b) direct the trial of an issue to determine the amount to be paid into court, and

(c) refuse the application if it is of the opinion that the determination of the aggregate amount which may be recovered by lien claimants should be made at the trial of the action.

2. *Section 30(1) of the Act should be amended so as to provide:*

> ... a claim of lien or liens for any amount may be enforced by action in the Court or an application made according to the practice and procedure of the Court ...

This provision should also apply to the discharge of liens referred to in Appendix A.

CHAPTER VII PRACTICE AND PROCEDURE

1. Jurisdiction and Venue

Jurisdiction in mechanics' lien actions is vested in the County Court.[1] This is so even though the amount in issue is far in excess of the usual jurisdictional limit of the County Court. The reason for this is in large measure historical. The aim of the *Mechanics' Lien Act* was originally to enable workmen and artisans to obtain payment quickly and cheaply out of the assets of the building owner. But the policies served by the Act have changed considerably in the course of time. The typical claim is no longer one for wages and today a large consolidated mechanics' lien action may involve several hundred thousand dollars. It is anomalous in these circumstances to give exclusive jurisdiction in mechanics' lien actions to the County Court. The factors which may have justified that approach originally have now disappeared. There appears to be no sound reason why this complex piece of legislation, which often leads to litigation involving large sums of money, should not be treated in the way other matters displaying these characteristics are treated viz. by conferring jurisdiction upon the Supreme Court.

The Commission recommends:

1. *The plaintiff in a mechanics' lien action may commence suit in the Supreme Court of British Columbia if the amount in issue exceeds $3,000 and if the plaintiff elects to begin such an action in the County Court, the defendant should be given the right to have the matter transferred to the Supreme Court of British Columbia.*

2. *For the purpose of recommendation (i), the "amount in issue" should mean the total amount in issue in a consolidated lien action, so that where there are several lien claimants, none of whom individually claim $3,000, but who collectively claim an amount in excess of $3,000, the action should be triable in the Supreme Court of British Columbia.*

According to section 2 of the Act, venue is at "the County Court of the county in which the land or any part thereof is situate upon which the improvement is made or is being made." It was held in *Pioneer Pipeline Contractors Ltd.* v. *British Columbia Oil Transmission Co. Ltd.*,[2] that the Act did not empower the court to change the venue of an action, since the Act itself provides for venue in mechanics' lien actions and thereby withdraws the question from the general power given to a judge of the County Court to change the venue if "the cause or matter can be more conveniently or fairly tried in some other County Court."[3]

The absence of a power to direct a change of venue may be a source of unnecessary inconvenience and expense. The parties may, for example, wish to litigate in Vancouver whereas the land is situated in the northern part of the Province. To insist that the action takes place in "the County Court of the county in which the land is situate" serves only to impose an unnecessary burden on the parties in such a case.

In the working paper, the Commission tentatively recommended that the general power vested in a judge of the County Court to direct a change of venue

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1. *See* ss. 2, 24, and 30 of the Act.

2. (1966), 57 W.W.R. 593. (Schultz, C.C.J., affirmed by the Court of Appeal. The Court of Appeal decision is not reported.)

3. *County Courts Act*, R.S.B.C. 1960, c. 81, s. 69, as amended.

should be extended to mechanics' liens actions. In the light of submissions received on this point, the Commission has decided to refine that suggestion somewhat.

The Commission recommends:

With the consent of all parties, a mechanics' lien action may be brought in any County Court. But in the absence of such consent, the action should be started in the county in which the land alleged to be subject to a lien is situated and any party should then be able to request a change of venue.

2. Procedure and Enforcement of a Right of Lien

The Commission recommends certain changes in relation to the following procedural matters:

(a) Notice to commence an action: section 26(2)

According to section 26(2):

> ... an owner may, after the filing of an affidavit of claim of lien, send to the claimant a notice in writing to commence an action to enforce the lien ...

If the lien claimant then fails to prosecute his action as required by the subsection, the owner may apply to the Registrar of Titles to have the lien cancelled under section 28(a). It is the practice of the Vancouver Registrar to interpret section 26(2) as meaning literally the owner, so that a notice sent by the owner's solicitor would not be sufficient for cancellation of the lien.

The Commission recommends:

Section 26(2) should be amended so as to allow the owner or his agent to send to the lien claimant a notice to commence an action, and Form II of the Schedule to the Act should be amended accordingly.

(b) *Lis pendens* and the cancellation of liens

According to section 26(1):

> In every case in respect of which an affidavit of claim of lien has been filed, an action to enforce the same shall be commenced and a certificate of *lis pendens* in respect thereof registered in the Land Registry Office and in the Mining Recorder's office in which the duplicate or certified copy of the affidavit has been filed not later than one year from the date of filing of the claim of lien.

This provision is absolute in its application. The wording appears to require the filing of a *lis pendens* even where money has been paid into court under section 33 and the lien has been cancelled.

In the recent case of *Alcock, Downing & Wright Ltd.* v. *ABA Plumbing & Heating Contractors Ltd.*,[4] the Court of Appeal, affirming Stewart C.C.J., held that where a payment into court has been made and the liens cancelled in accordance with section 33, a lien claimant may still maintain his action even though he has not registered a certificate of *lis pendens* in accordance with section 26(1).

4. (1972), 23 D.L.R. (3d) 728 (Co. Ct. of Westminster). The decision of the Court of Appeal is not yet reported.

The Commission, with respect, agrees that this decision is eminently sensible. But this is another instance of where, in order to make the Act workable, it is necessary to give a less than literal interpretation of some of its provisions.

The Commission regard the filing of a *lis pendens* as unnecessary where a payment into court of the amount of the lien claim has been made, since the effect of such a payment is to transfer the lien claimant's security from the land to a fund of money.

Similarly, if the Commission's suggestion that the owner should be entitled, to have liens discharged on payment into court of the relevant amount of the holdback,[5] were adopted, the same reasoning would apply.

The Commission recommends:

Where a lien has been cancelled as a result of security having been given in accordance with section 33 or where a lien has been removed as a result of payment into court of the aggregate amount recoverable by lien claimants, it should not be necessary for the lien claimant or the lien claimants to register a certificate of lis pendens.

(c) Procedure to file a lien

According to the Act, in order to file a claim of lien in respect of land outside the counties of Vancouver, Victoria and Westminster, an affidavit of claim of lien must be filed in both the appropriate Land Registry Office and in the appropriate County Court Registry.[6] Within these three counties, it is only necessary to file in the Land Registry Office.

This additional requirement in respect of lands outside Vancouver, Victoria and Westminster was no doubt based on the fact that communications in the interior were difficult and a search in the local County Court Registry could be conducted more easily and cheaply than in the Land Registry Office. It is questionable whether today there is a need to file a claim of lien in the County Court Registry. The same observation might be made in connection with the requirement that an affidavit of claim of lien in respect of mining property be filed in the nearest County Court Registry.[7]

It is also apparent that the requirement of filing in the County Court Registry is a trap for lawyers practising in Vancouver, Victoria and New Westminster when called upon to file a lien outside these areas, and it is not uncommon for lawyers to be caught opt by the requirement.

The Commission recommends:

It should be no longer necessary to file an affidavit of claim of lien under the Act in the County Court Registry and that sections 24 and 25 of the Act should be amended accordingly.

(d) *Proof of delivery of materials*

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5. *Supra*, p. 12.

6. *See* s. 24.

7. *See* s. 25.

A problem which arises quite frequently in a lien action brought by a materialman is that the materialman is unable to prove delivery to the improvement of the materials he supplied. Some kinds of materials are, and remain, readily identifiable. But others may lose their identity when incorporated into the improvement.

The only real answer to this problem is for the supplier to keep careful records of delivery of materials to the particular improvement. The Commission feels, however, that there would be value in highlighting the problem and encouraging the necessary record keeping by inserting a provision in the Act providing for the use of receipts as evidence of delivery to the site.

The Commission recommends:

The addition to the Act of a section providing that if the person to whom materials were supplied, or his agent, signs an acknowledgment of receipt of the materials stating that they are received for inclusion in an improvement at a named address, the materials will prima facie be deemed to have been delivered to the land described by the address.

(e) Costs

At the moment, although a plaintiff may be able to obtain costs according to the Supreme Court tariff where the amount in issue exceeds $3,000, it is clear that the defendant cannot. In the Commission's view, the plaintiff and defendant should be treated in the same fashion and both should be able to recover costs according to the Supreme Court tariff when the amount in issue exceeds $3,000. The reference to the *Mechanics' Lien Act* in Schedule 3 of the County Court Rules should be deleted.

The Commission recommends:

Where the amount in issue in a mechanics' lien action exceeds $3,000, costs, whether of the plaintiff or the defendant, should be taxed according to the Supreme Court tariff.

CHAPTER VIII THE LABOUR AND MATERIAL PAYMENT BOND: AN ALTERNATIVE TO THE HOLDBACK SYSTEM

1. Introduction

It has already been pointed out that, if an attempt is to be made to give additional protection to people who contribute to an improvement over and above that given by the law of contract, one great difficulty is to reconcile the mechanics of the system of providing for that protection with the need to encourage the ready flow of funds along the construction chain. The holdback system discourages this flow, and indeed, any system which requires part of the contract moneys themselves to be set aside to provide security for people who contribute to an improvement is likely to have a similar effect.

The Amalgamated Construction Association of British Columbia has recommended that if a contractor supplies a bond of a defined type, this should function as a partial alternative to the requirement that the owner retain a holdback from the contractor. The original form of the Association's recommendation made reference to performance bonds and to labour and material payment bonds.

A performance bond is a guarantee that if the principal (the party who obtains the guarantee) fails to carry out his obligations, the surety will pay a sum of money to the person employing the principal. A labour and material payment bond is a guarantee that if the principal fails to pay the people he employs to provide labour and material for the improvement, the surety will be liable to pay them up to an amount specified in the bond.

In the case of a performance bond, the person employing the principal is generally referred to as the obliges. He is the person for whose benefit the guarantee is intended. In the case of a labour and material payment bond, the person employing the principal is again generally referred to as the obligee, and the persons employed by the principal to provide labour and material are referred to as claimants. The labour and material payment bond is a guarantee in favour of the claimants.

The following is the text of the original recommendations made by the Amalgamated Construction Association:

> Notwithstanding Section 6, in all cases the owner or person primarily liable upon any contract under or by virtue of which a lien may arise shall retain, for a period of forty (40) days after the contract has been completed, abandoned, or otherwise determined, a percentage of the value of the work, service and materials actually done, placed or furnished as mentioned in section 5 in accordance with the following table irrespective of whether the contract or subcontract provides for partial payments or payment on completion of the work, and the value shall be calculated upon evidence given in that regard on the basis of the contract price, or if there is no specific contract price, then on the basis of the actual value of the work, service, or materials.

Value of Project	Percentage Without Performance	Percentage with with a Performance and	Percentage Performanc e and

			Labour and Material Payment Bond
Below $100,000	15	10	5
Over $100,000	10	7 ½	5

After further consideration and some discussion with the Commission's representatives, this proposal was modified somewhat by eliminating the separate category headed "Percentage with a Performance Bond" and subsuming it under the category headed "Percentage without Bonding" and by altering the figure of 10 per cent under the latter category for contracts over $100,000 to 15 per cent. In the result the table would be considerably simplified, eliminating the separate category of performance bonds and removing all differences in percentage to be retained based on the value of the project.

These modifications were based upon a that a performance bond does not generally give any additional security to lien claimants and hence should not result in the holdback being reduced and that a single reduction in the holdback by 5 per cent when the project exceeds $100,000 is not on its own likely to improve the flow of funds as long as the contractor's and subcontractor's exposure to risk is unlimited. The minutes of the meeting of the Lien Act Revision Committee of the Amalgamated Construction Association recorded the modification in the following terms:

> It was ... recommended that without bonding the holdback percentage should be 15 per cent, but where a 50 per cent labour and material payment bond is carried by the prime contractor, the holdback should be reduced to 5 per cent.

The Commission has given lengthy consideration to this proposal and has decided to recommend a modified version of the submission made by the Amalgamated Construction Association. What the Commission recommends is intended, like the proposal of the Amalgamated Construction Association, as an optional alternative to the holdback and lien system. The parties may still, if they prefer, operate according to the holdback and lien system.

The advantage of a bond as an optional alternative to the holdback and lien system is that it does not require part of the contract moneys to be set aside to meet the possible claims of lien holders. This is a considerable benefit in dealing with the problem of the flow of funds. The incidence of bonding is becoming more common, particularly in large projects. The Commission believes that advantage can be taken of this development to fashion a provision which provides the same degree of protection to lien claimants as they would have if there were holdbacks. The difference would be that the security would take the form of a guarantee rather than a holdback of part of the money due in connection with the contract.

On considering the proposal to recommend bonding as an alternative to the holdback system, the Commission at first felt there were certain problems in connection with the proposal that might not he easy to overcome. These were:

(1) Would the bond provide as much protection to lien claimants as they get under the holdback and lien system?

(2) Would the result of providing the alternative of a bond mean that some contractors and subcontractors might be prepared only to employ subcontractors and sub-subcontractors who would supply the necessary type of bond and if that development occurred, would the result be that the bonding companies acquired the power to determine who should carry on business and who should not?

(3) Would the bonding companies be prepared to stand by their guarantees without raising technical reasons for delaying payment or refusing to honour their guarantee? It is perhaps ironic that at the time the Commission was considering this question, the case of the *Town of Truro* v. *McCulloch*[1] was reported in which a bonding company tried to assert that it was not liable on a labour and material payment bond on the ground that the person to whom payment was promised was not a party to the bond and therefore could not sue on it. The defence failed and it would have stood even less chance of succeeding in this province in view of the statutory provision permitting the person to whom payment is promised to sue the bonding company.[2] The fear the case arouses is not so much the possibility that the bonding company's defence might have been successful, or might on slightly different facts be successful, but the implication that bonding companies will seek to find ways of avoiding what the industry understands to be their responsibility, thereby making this form of security a less valuable protection than that which the holdback and lien system provides.

(4) Would the cost of the bonding alternative be too great, thereby adding to the cost of construction?

All of these points caused the Commission to tread carefully in considering whether it would be right to make a recommendation concerning the bonding alternative. We feel that there is reason to hope that these different problems have been surmounted by the recommendation we make. It is impossible to be sure that the expectations of claimants as to recovery and the expectations of bonding companies as to liability will always coincide. But the key to the success of the scheme we propose is simply whether the bonding companies are prepared to undertake responsibly the function of providing an alternative to the holdback. If they are, the scheme will succeed. If they are not, the scheme will fail.

The matter about which we are the least confident is the cost to the industry if our recommendations are implemented and taken advantage of by members of the industry. Several points must be borne in mind here. The bond alternative we propose is not in all respects identical with the form of labour and material payment bond currently in use. Whether this will mean that the premium to be charged for the type of bond we propose will be higher than that presently charged for a labour and material payment bond, or whether any additional cost to the industry can be absorbed by the possible increase in the amount of bonding or offset by appropriate contractual arrangements, cannot easily be foreseen in advance and will have to await experience with the proposed scheme.

As against that, the advantage of the scheme is that the flow of funds along the construction chain should be assisted and the cost of obtaining finance for these engaged on the improvement thereby lessened. In addition, in situations where at the moment the parties do not obtain a labour and material plyment bond, but where the removal of the holdback requirement as a *quia pro quo* for taking out such a bond might serve as an inducement to do so, the fact that lien claimants will thereby generally receive better security must also be borne in mind.

1. (1972) 22 D.L.R. (3d) 293 (S.C.N.S.)

2. *See Laws Declaratory Act*, R.S.B.C. 19604 c. 213, s. 2(39).

If our recommendations in connection with bonding are accepted and implemented, British Columbia will be the first province to tie the rights of security contained in the Act to the kind of security which has been developed within the industry itself. If our proposal is successful, this will, we believe, be a useful piece of rationalization.

2. Outline of the Operation of the Bond Alternative

Under the separate holdback system the Commission has proposed, the holdback retained from the contractor is intended to discharge the lien rights of people the contractor employed (subcontractors and suppliers of the contractor); the holdback retained from a subcontractor is intended to discharge the lien rights of people the subcontractor employed (sub-subcontractors claiming under the subcontractor and suppliers of the subcontractor); and so on. The bond is intended to operate as an alternative to the holdback and will operate within the same structure of relationships as the separate holdback system. The owner's holdback acts as a security for people employed by the contractor. If the contractor provides the alternative security, i.e. the bond, security in the form of a holdback is replaced and there is no statutory obligation on the owner to retain a holdback.

The separate holdback scheme contemplates that each party in the construction chain will retain a holdback as security for the person next but one below him. Thus, the owner's holdback is only intended as security for people employed by the contractor. Only in the exceptional case of a string of bankruptcies will the owner's holdback be used to pay people who are below the level of people employed by the contractor. The next stage is, therefore, to provide for what happens to the security intended for the people employed by subcontractors, i.e. sub-subcontractors and suppliers of subcontractors. Under the separate holdback scheme, this security takes the form of the holdback retained by the contractor from the subcontractors. Under the bonding alternative, it will take the form of a bond obtainod by the subcontractor. If the subcontractor provides the necessary bond, the contractor will not be required to retain a holdback, since the security for these employed by the subcontractor now lies in the bond and not in a holdback retained from the subcontractor.

It will be seen from this that the bonding arrangement the Commission proposes as an alternative to the holdback is very much geared to our recommendation concerning the separate holdback system. At each level, a party will be faced with an alternative under the Statute. He can provide the necessary bond, in which case there will be no statutory obligation on the person who employs him to retain a holdback; or if he does not supply the bond, the person who employs him will be under the usual statutory obligation to retain a holdback of 15 per cent.

There are two principal reasons why the Commission preferred this way of structuring the bond alternative to the idea of a single bond against to which all lien claimants would look for recovery.

Firstly, we felt that we should, so far as possible, take advantage of the existing form of bonding arrangements. The kind of bond we propose as an alternative to the holdback is a payment bond. As part of his obligation under a labour and material payment bond, the surety guarantees payment of an amount equal to the holdback for which the person employing the principal debtor would have been liable if there had been no bond. The form of payment bond currently

in use in the industry provides that only people who contract directly with the principal debtor are able to claim under the bond. People who are lower down in the construction chain may have a contractual claim against these claiming against the bond; but such people lower down have themselves no direct claim against the surety. The Commission did not want to upset this technique of providing security unless it was essential to do so.

We do not believe it necessary to interfere with the usual definition of who may claim against a bond for the purpose of the proposed alternative bond scheme. If a contractor takes out the necessary type of bond, the consequence is that the owner will be under no statutory obligation to retain a holdback and the contractor will have a right to prompt payment in full, subject to whatever alternative contractual arrangements are made. But this bond is not intended to provide security for people below the level of persons employed directly by the contractor (the sub-subcontractors and suppliers of the subcontractors). The security to which these people are entitled to look will be either a hoidback retained by the contractor from the subcontractor or a bond obtained by the subcontractor whc employed them.

At each level in the construction chain, the option is open to a party of obtaining a bond or having a holdback retained by the person employing the party. Where the contractor obtains a bond, but not the subcontractor; the persons employed directly by the contractor will look to the bond for security. But the persons employed by the subcontractor will look not to the bond, but the holdback retained by the contractor from the subcontractor.

Secondly, the Commission felt that if the form of the guarantee the bonding company was asked to provide amounted in effect to a guarantee not only of the obligations of the principal debtor, but of others lower down in the construction chain (which would be the result of people other than these who contracted directly with the principal debtor could claim under the bond), then we would have provided for a set of obligations that a bonding company would have great difficulty in undertaking. The bonding company would be guaranteeing not only the debts of the principal debtor, but also the debts of several other people. This would make the degree of risk of the guarantor difficult to estimate, it would make it more difficult for a contractor to obtain a guarantee and it might result in the realization of the fear we expressed above that the bonding companies would, as to certain projects, exercise a power of veto over subcontractors. This is because the contractor would not merely be exercising his right to prefer subcontractors who can obtain bonding to these who cannot, but because the contractor might not himself be able to obtain bonding unless his subcontractors were approved by the surety.

In summary, the Commission believes that there are several undesirable possibilities that might result from a direct replacement, complete or partial, of the holdback system as it exists under the present law by the bonding alternative. It might reduce the effectiveness of the scheme, make it more difficult to administer or imply too great a degree of dependence by subcontractors on the approval of bonding companies. In addition, it would be out of harmony with the separate holdback system we propose and which, for reasons already discussed, we prefer to the present holdback system.

3. The Position of the Surety under the Bond Alternative

In recommending the bond alternative, the Commission has tried to make as great a use as possible of bonding practices that already exist in the industry. We

have done this partly to encourage acceptance of the scheme by relying on features that are already familiar to people in the industry; and partly because the practices and forms of providing surety bonds are the product of the experience of these engaged in the industry. That being so, we felt the best procedure was to formalise in the proposed bond alternative as many of the results of that experience, in the shape of the standard form of bonds currently in use, as were consistent with affording the necessary degree of protection to lien claimants.

The bond alternative the Commission proposes is not intended to be a new creation involving an unfamiliar type of surety. The alternative we recommend is based on the present form of labour and material payment bond and, as we conceive it, it would impose no new or additional substantive liability on the surety under a labour and material payment bond. What it would involve is a change in the time at which the surety would be expected to react to the fact that claims were being made against him.

In order to explain what the position of the surety would be under the bond alternative, it is necessary first to say a little more about the usual form of labour and material payment bond. In some projects the contractor and all of the subcontractors, and perhaps also the subsubcontractors may obtain labour and material payment bonds. For the purpose of describing the operation of a standard form labour and material payment bond, the case of the contractor is sufficiently illustrative.

A labour and material payment bond obtained by a contractor is an undertaking by the contractor (the principal) and the bonding company (the surety) to the owner (the obliges) that they will be liable to claimants for a certain sum. Claimants are defined in the bond as people who contract with the principal for the provision of labour or material in connection with performance of the contract between the principal and the obligee. If the principal fulfils his contractual obligations to pay the persons defined as claimants, the obligation of the surety is discharged. If the principal fails to pay the claimants, the surety's obligation remains in being. It will be seen that the obligation imposed on the surety is analogous to a guarantee.

In the case of the ordinary labour and material payment bond, the maximum sum for which the surety is liable on default by the contractor is half the prime contract price, Although guarantees for a greater proportion of the prime contract price are sometimes undertaken. In most cases however, half of the contract price will be a sufficient sum to satisfy the claims of people employed by the contractor.

Not all of the standard forms of labour and material payment bond currently in use are in identical form. There has been little case law concerning bonds in Canada and it is not clear what effect slight differences in wording from one form of bond to another may have. However, the elements of a labour and material payment bond approximate in general to these set out above.

In order for the bond obtained by the contractor to provide an alternative form of security to the holdback, it is not necessary to make any change in the elements that currently constitute a labour and material payment bond. The changes that are necessary lie in the way the guarantee is administered. Under the proposed scheme, where the contractor has obtained the necessary bond and the owner was therefore under no statutory obligation to retain a holdback, the bond is security for the people employed by the contractor (subcontractors'and suppliers to the contractor). The mechanics of the scheme involve no change in the

position of the subcontractors and materialmen. They may exercise their right to file a lien in the normal way.

If a subcontractor files a lien, this will generally indicate insolvency on the part of the contractor. If in fact the contractor is solvent, he will simply pay off the lien claimant in the normal way and just as under the present law the owner's holdback would not be called upon, so under the proposed alternative, the surety would not be called upon.

Assuming the contractor to be insolvent however, what must the surety now do when the subcontractor files a lien? The principle of the scheme is that the bond will fulfil the same function as the holdback does under the present law. It would therefore be the duty of the surety to discharge the liens. This may be done by payment of the amounts for which liens are claimed, or payment into court of the owner's holdback, or such part of it as is necessary to discharge the liens (or of the amount of the lien claims where this is less than would have been the relevant amount of the owner's statutory holdback).

The essence of the scheme is that the bond must not only provide alternative security, but it must provide it promptly. Thus, whilst no change is proposed in the substantive obligations of a surety under a standard form labour and material payment bond, it is intended that, in order for the owner to be relieved of the statutory obligation to retain a holdback, the surety must have undertaken an obligation to remove the liens as quickly as is reasonably possible. At the moment, as soon as liens are filed, the owner is anxious to see them removed quickly. The theory of the Act as it is presently drafted is that holdbacks are available for this purpose. If holdbacks are to be dispensed with, the surety will be required to undertake this obligation. It is therefore proposed that the alternative security must impose an obligation on the surety to remove liens within fourteen days of their being registered. Removal of the liens will occur in the normal way i.e., settlement, payment or payment into court.

If this scheme were to gain general acceptance as an alternative to the holdback, it is clear that there would be significant advantages in terms of the flow of funds along the construction chain. Whether it will gain acceptance will depend on whether the bonding companies feel able to undertake the obligations which would be required under the alternative scheme. It is therefore important to examine how much of a change from the position under the present form of labour and material payment bond is involved in these obligations.

If liens are filed and the surety is called upon to discharge the liens, he will be obligated to the owner to make the necessary payment, or payment into court. If at the trial, the liens turn out to be invalid, or inflated in amount, the surety will simply request payment out of any balance. If the liens are valid and the lien holders obtain judgment for the sum, or part of the sum paid into court, the effect will be that the total amount by which the lien holders are unpaid will be correspondingly reduced. When and if they, therefore, make a claim under the labour and material payment bond, independently of their lien rights, their claim will be reduced by the amount already paid out in discharge of the liens. The level of liability of the surety is not therefore increased.

In addition, it is intended that the maximum total liability of the bonding company should not be statutorily expanded beyond the normal 50 per cent figure, so that if the claims of subcontractors are so large that they would more than eat up this figure, any sum paid out by the surety in discharging the liens will

be set off against the surety's obligation to claimants who claim directly against the labour and material payment bond.

The obligation imposed on the surety to make a prompt payment into court if liens are filed is not intended to be a statutory term of all labour and material payment bonds that are issued in respect of improvements carried out in the Province. It is intended to create a device of which the parties may or may not, at their option, take advantage. If they choose to opt in favour of this device, the statutory obligation to retain a holdback imposed on the person in the position of the obligee does not apply; if they choose not to take advantage of the device, the obligeers duty to retain a holdback continues in full force and effect.

The terms of the surety's duty under a modified form of labour and material payment bond, which for convenience may be termed a holdback bond, require to be worked out with a reasonable degree of certainty. Just as in the case of the ordinary labour and material payment bond, the surety does not undertake primary liability, so in the case of the holdback bond, the surety is liable only as a guarantor of the principal. Consequently, the form of the surety's obligation should be that he undertakes to remove any liens registered against the owner's title under the *Mechanics' Lien Act*, provided that if the liens have been removed within seven days by the contractor or any other person, this obligation shall be null and void. It should also be made clear that where the amount required to be paid into court in order to remove the liens varies depending on whether the principal or some other party makes the payment in, the surety discharges his obligation by payment in of the amount the principal would have been required to pay in.

One aspect of the proposed scheme, which may be of significance in assessing the position of the bonding company, is that there will be no statutory holdback in the hands of the owner. There is, of course, nothing to stop the various parties contracting for a holdback; but the object of the scheme is to create the.means for aiding the flow of funds. It is to be expected that the practice of the industry will crystallize around some generally acceptable contractual arrangement. Members of the industry may find that a small holdback, such as five per cent, retained from the contractor, is desirable, and the bonding companies may wish to see some such figure.[3] On the other hand, it may be that in many cases the parties will be happy to do without the holdback altogether.

The attitude of the bonding companies towards the holdback is going to be of significance in setting the tone for the practice of the industry. Under the present law if the owner has retained a holdback of 15 per cent of the value of the work done under the prime contract, and if the contractor has obtained a labour and material payment bond, the surety will normally take over responsibility for the project if the contractor abandons the job. It is usual practice amongst construction underwriters not to issue a labour and material payment bond unless they have also issued a performance bond. The performance bond is a guarantee go the owner of performance by the contractor. It starts to operate when the contractor defaults in his obligations under the contract and it gives the bonding company the right to take over the contractor's contract and to complete it. When the contractor is in default and the surely takes over performance of the prime contract, the surety in effect receives the benefit of the owner's holdback. If liens

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3. On government contracts to which the Act does not at the present time apply, there is usually in fact a contractual holdback of five per cent.

have been filed, the surety may, as guarantor of the contractor, discharge the liens.[4] But the holdback retained by the owner will ultimately become available for payment. When it does, the surety will be entitled to receive it. If, on the other hand, there were no holdback, and the contractor had been paid everything he was owed, the surety would lose this advantage. The significant question is, therefore, how important is the holdback to the surety, and how far would his position be changed if the holdback did not exist.

The first charge on the holdback funds is that of the lien claimants. Even though the surety is subrogated to the rights of the contractor vis a vis the owner, any sum of money still owing to the contractor must, in practice, be applied to discharge liens first. Despite the surety's right of subrogation, the owner is not obliged to pay to the contractor the sum he has retained in so far as it is necessary to discharge liens and in fact he will be generally anxious to remove the liens as soon as possible. Where the owner has terminated his contract with the contractor, and, as invariably occurs, it appears likely that there will be additional cost over and above the original contract price in completing the improvement, the owner is entitled to apply any sums he owes to the contractor in excess of the 15 per cent holdback to complete the building.[5] The surety will therefore be entitled under his right of subrogation to these sums. The 15 per cent holdback is not, however, available to the surety.[6] It must be used to pay the lien claimants. If it is not, the owner will not be entitled to have the liens removed, or will have to obtain the money to remove them from some other source.

It will be seen from this that, although under the proposed new scheme, there will be no statutory holdback, the present law does not permit the bonding company access to the holdback since the owner has the duty to remove the liens and the right to use the statutory holdback for that purpose.

On the other hand, even though the first charge against the holdback is, under the present law, the removal of liens, the application of the holdback moneys to the claims of lien claimants has the effect of reducing, or in some cases, discharging entirely the indebtedness of the contractor to the subcontractors. If there is no holdback and nothing in the owner's hands to remove the liens, it follows that the amount of the potential claims against the surety will not have been *pro tanto* reduced. If there had been a holdback which could be paid into court to remove liens, and ultimately paid out to lien holders, their claims against the surety would be reduced by the amount they received out of the holdback. With no such partial discharge, the claimants will be able to claim in full against the surety.

From the surety's point of view, this is a disadvantage. But its effect should not be exaggerated. Firstly, one consequence of the owner having retained no holdback, and of having paid the contractor in full for the value of the work done

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4. Whether the surety is bound under the terms of his performance bond to remove the liens does not seem to be settled. The practical effect is that if the surety is so bound, he may then under his right of subrogation, and subject to any right of set-off the owner may have, call upon the owner to disgorge any holdbacks he may have; if he is not so bound, and the owner cannot call upon him to carry out the owner's statutory obligation to pay lien claimants, the surety has no right of subrogation as to the holdbacks.

5. This is probably the position of the present law, and the Commission has recommended *supra* that this should be spelled out in the Act.

6. Unless the surety himself has discharged the liens, in which case his right of subrogation will also embrace the 15 per cent holdback.

is that the contractor should have paid more money to his subcontractors, the people who will be claimants under the bond. There is no guarantee of this of course and it is perfectly possible that the contractor will have paid no more to his subcontractors in that situation than he would have done if the owner had retained a holdback. But it is likely that in many situations some, or even all, of that 15 per cent which has been paid to the contractor rather than held back, will have flowed down to subcontractors, thereby reducing the amounts of their claims against the surety.

Secondly, where the owner retains no holdback from the contractor, but is contractually obliged to pay to him the total value of the work done under the contract from time to time, this fact will obviously be known to the claimants and the surety. Their assessment of the contractor's continued solvency will therefore take account of this fact, and there will be a degree of slowness in paying subcontractors and suppliers, acceptable if the owner were retaining a 15 per cent holdback, which will become a cause for concern if it is known that the contractor is in fact receiving that 15 per cent from the owner. The indicia of impending insolvency would therefore reflect the fact that the owner was retaining no holdback, and the absence of the holdback would not mean that the contractor would simply have another 15 per cent of the contract moneys to dissipate, nor that the loss of that 15 percent would simply be passed on to the surety.

Thirdly, the money which the contractor receives is trust money in his hands. The subcontractors and suppliers who are claimants under the bond are also beneficiaries of money in the contractor's hands. To the extent that the contractor still has part of that money, the claimants will usually have priority over the various other species of creditors of the contractory if the contractor has paid the money to a third party there will in some circumstances be the possibility of tracings and the claimants will defeat the contractor's trustee in bankruptcy.

These various circumstances will have to be taken into account by the bonding companies when they decide whether they are able to offer the kind of guarantee which the Commission proposes as an alternative to the holdback. The bonding companies may feel that an additional premium will have to be charged if in their view there is additional risk imposed on them, or if the task of policing the contractor's activities so as to eliminate additional risk involves extra administrative cost. Or the bonding companies may feel that they can only offer the labour and material payment bond with a holdback guarantee if the owner retains some proportion - say five per cent - of the value of the work done. These matters will remain unknown until the industry has had some experience in dealing with the new scheme, assuming it is acceptable to the legislature. The important point to stress, however, is that this proposed scheme is only an alternative to the holdback system. If the new scheme fails to gain acceptance, we will simply be left with the present holdback and lien system, or, if it is accepted, the amended version of it which the Commission has recommended.

The position of the bonding company under the proposed holdback bond is, in summary, that it will be obliged to remove liens within fourteen days of their being registered if its principal fails to do so; and there will be no statutory holdback retained by the owner. The surety is not required, under the holdback bond, to undertake liability for any amount in excess of 50 per cent of the prime contract price.

4. The Position of the Contractor under the Bond Alternative

The position of the contractor who has obtained labour and material payment bond with the necessary holdback guarantee is no different from what it would be under the proposed separate holdback scheme as far as liability and risk are concerned. The holdback guarantee does not relieve the contractor of his contractual liability to the owner in respect of discharging liens. It only operates if there is a default by the contractor.

The major change in the position of the contractor occurs in the context of the flow of funds along the construction chain. The owner would, if there is a holdback guarantee, no longer be under a statutory obligation to retain 15 per cent of the value of the work done from the contractor. Subject to any different arrangement made between the owner and the contractor therefore, whether on their own initiative, or at the insistance of the surety, the contractor would have the right to be paid in full according to the provisions of the contract between himself and the owner. This would provide considerable encouragement to the flow of funds along the construction chain.

In one respect the contractor's position is a peculiar one. He is entitled to register a lien under the Act for the amount by which he is unpaid, but there is no security in the form of holdbacks available to satisfy the contractor's claim in the same way that there is for claims which arise below the contractor. A holdback retained by the owner from the contractor does not of course have this function, since all that is implied by saying the owner has retained a holdback of $X is that the contractor remains unpaid in the amount of $X. This is scarcely a security. In fact, in the case of the contractor, far from providing any security, the owner's holdback simply marks the amount of his indebtedness to the contractor.

On the other hand, despite the absence of security in the form of holdbacks, the contractor's right to register a lien against the owner's title gives him the right to treat the land and the improvement as security and, if he is unpaid, to call for sale of the land under section 30(2) of the Act.

The holdback bond which the Commission proposes is of no assistance to the contractor. Even if the contractor, all the subcontractors and all the sub-subcontractors obtain holdback bonds, this does not provide any security for the contractor. The only form of additional security which could be made available to a contractor would be a guarantee of payment by the owner to the contractor. Such guarantees are not, however, common in the industry and the Commission does not propose to incorporate them into the Act as an alternative form of security for the contractor.

In the result, the Commission believes that the position of the contractor with regard to filing liens and claiming the land and the improvement as security under the Act should be left untouched by our holdback bond proposal. If a contractor files a lien, this indicates default by the owner, which in turn puts an end to the usual right of the owner to require the contractor to remove liens. Similarly, if the owner is in default and if a contractor files a lien, the surety's guarantee to discharge liens is inoperative. It is a guarantee only of the contractor's liability to remove liens, and when that liability goes, so does the guarantee. The existence of a holdback bond obtained by the contractor therefore gives the owner no rights when he is in default and it is the contractor who claims a lien

5. The Position of the Owner under the Bond Alternative

The basic position of the owner under the holdback bond is also quite

straightforward. As long as the contractor obtains the required bond, the security available to lien claimants employed by the contractor will no longer be the owner's holdback, but the bonding company's guarantee. The owner will therefore be under no statutory obligation to retain a holdback.

Lien claimants will be able to file liens in the normal way, but the owner will be entitled to look to the contractor to remove them, and on his failure to do so, to the surety. The owner will, in normal circumstances, not have to remove the liens himself. The lien holders will still have a lien against the owner's land and the improvement. If the surety, for one reason or another fails to remove the lien, the only amount for which the owner can be liable will be the value of the work done less any amount he has paid bona fide to the contractor. In other words, he will be liable only for any *de facto* holdback he has retained.

One complication which may occur is that the surety might prove insolvent or might escape liability under the guarantee. In this situation, the question arises as to who, as between owner and lien claimants, should bear the loss of the contractor's default and the worthlessness of the guarantee. This situation is not likely to occur as long as the people who are permitted to engage in this form of bonding are confined to reputable surety companies. Even so, there is always the possibility that the owner and contractor will commit some act which releases the surety from his obligation. The most usual form of such act is that the parties to the contract, performance of which is guaranteed, agree on a variation of the obligations without the consent of the surety. The effect of such a variation will be to release the surety from liability as a guarantor since the obligations as varied are not these he agreed to guarantee. Variations in the contract between owner and contractor are most likely to affect the enforceability of the performance bond rather than the payment bond since the latter is a guarantee of the contractor's obligations to the people he employs. As to the payment bond therefore, the main threat to enforceability lies in the claimant agreeing to a variation of his contract with the contractor.[7]

The Commission believes that this possibility is a trap for the unwary subcontractor or supplier. He may not realize that the consequence of his willingness to amend his contract at the contractor's request may be the loss of his rights against the surety. We propose therefore that a surety who guarantees payment under a labour and material bond should be under an obligation to give notice to the various claimants as defined in the bond that any proposed variation of their obligations in connection with the improvement should be communicated to the surety. The surety should have the right to refuse his approval to the proposed variation, but unless he does so within ten days, the variation in the claimant's obligation may be made without affecting the rights of the claimant under the bond to claim against the surety for amounts unpaid in respect of the improvement.

If the surety fails to give this notice to the claimant, it is proposed that he will not be able to raise the defence vis a vis that claimant that a material change in the contractor's obligations to the claimant has released the surety. If, on the other hand, the surety gives the prescribed notice, but the claimant agrees to a variation of his contract without giving notice of the proposed variation to the surety, or

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7. C.F. Simpson on Suretyship (St. Paul, Minn., 1950) at p. 349: "It is also generally held that third parties who acquire rights under a suretyship contract are not affected by alterations of the original agreement by the obligee and the principal. This view is most often applied where a bond to secure the performance of a contract for the construction of public works, or a statute governing such contracts, provides that the bond shall enure to the benefit of persons who furnish labour or materials for the completion of the project."

after receiving the surety's refusal to approve the proposed variation, the general law in relation to a surety's discharge from his obligation will apply.

The clearest statement of that general law is perhaps that of Cotton L.J. in *Holme* v. *Brunskill*.[8] Cotton L.J.'s statement of the law relating to a surety's discharge from his obligations has been cited and followed in a number of Canadian decisions.[9] That learned judge said:[10]

> Where a creditor does bind himself to give time to the principal debtor, he with an exception hereafter referred to, does deprive the surety of a right which he has, that is to say of the right at once to pay off the debt which he has guaranteed, and to sue the principal debtor, and without inquiry whether the surety has, by being deprived of this right, in fact suffered any loss, the Courts have held that he is discharged. The exception to which I have referred is, where the creditor on making the agreement with the principal debtor expressly reserves his right against the surety, but this reservation is held to preserve to the surety the right above referred to, of which he would otherwise be deprived. The cases as to discharge of a surety by an agreement made by the creditor, to give time to the principal debtor, are only an exemplification of the rule stated by Lord Loughborough in the case of *Rees* v. *Berrington* (1795) 2 Ves. J. 540, 30 E.R. 765: "It is the clearest and most evident equity not to carry on any transaction without the knowledge of him [the surety], who must necessarily, have a concern in every transaction with the principal debtor. You cannot keep him bound and transact his affairs (for they are as much his as your own) without consulting him."
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> The true rule in my opinion is, that if there is any agreement between the principals with reference to the contract guaranteed, the surety ought to be consulted, and that if he has not consented to the alteration, Although in cases where it is without inquiry evident that the alteration is unsubstantial, or that it cannot be otherwise than beneficial to the surety, the surety may not be discharged; yet, that if it is not self-evident that the alteration is substantial, or one which cannot be prejudicial to the surety, the Court, will not, in an action against the surety, go into an inquiry as to the effect of the alteration, or allow the question, whether the surety is discharged or not, to be determined by the finding of a jury as to the materiality of the alteration or on the question whether it is to the prejudice of the surety, but will hold that in such a case the surety himself must be the sole judge whether or not he will consent to remain liable notwithstanding the alteration, and that if he has not so consented he will be discharged.

From this it will be apparent that, at the risk of losing the security of the guarantee, the claimant should, in all but the most obvious cases, give notice of a proposed variation to the surety.[11] The mechanism we propose will, we hope,

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8. (1878), 3 Q.B.D. 495; 47 L.J.Q.3. 610

9. *Austin* v. *Gibson* (1879) 4 O.A.R. 316; *Egbert* v. *Northern Crown Bank* [1918] 3 W.W.R. 132; [1918] A.C. 903 (Alta); 42 D.L.R. 326; *Doe* v. *Canadian Surety Co.* [1937] S.C.R.1; 4 I.L.R. 43; *Preload Company of Canada* v. *Regina* (City) [1959] S.C.R. 801; *Bell.* v. *National Forest Products Ltd*, (1964) 47 W.W.R. 449; 45 D.L.R. (20) 249 (B.C.)

10. (1878) 3 Q.B.D. 495 at p. 505.

11. In the U.S.A. it appears that a doctrine of implied consent on the part of the surety to variations in the obligation has been developed. According to Simpson (op. cit.) at p. 345 "... if the change is of a degree and kind which is common in such transactions, then the obligeers subsequent agreement is within the contemplation of the surety's promise. It seems reasonable to assume that the obligee is intended to enjoy the protection of the surety's promise so long as his acts accord with common practice, for this must be the type of behaviour contemplated by the surety. This approach would seem to justify holding the surety when minor and unsubstantial alterations are made in the specifications of a building contract." Simpson also notes the case of *Cooke* v. *White Common School District No.*

reduce the likelihood of unexpected loss of the security through failure to obtain the surety's consent.

In practice, bonding companies do not examine the various subcontracts and contracts for the supply of materials before issuing a labour and material payment bond. They are concerned principally with the financial stability, amount of capital and experience and competence of the principal. Having been assured on these matters, the bonding companies do not in fact exercise any close supervision over the liabilities the principal undertakes in respect of labour and material, payment of which they are guaranteeing. The surety will not therefore generally know the identity of the various claimants at the time a labour and material payment bond is issued.

This of course means that they would not, if they continued their present practice, be in a position to give the notice we propose to require them to give to the various claimants. But this also indicates that the bonding companies are not unduly concerned to give their approval to each particular obligation the contractor undertakes with respect to labour and material, and hence are not likely to be concerned with variations in these obligations. The fact that the bonding companies will not generally know who are the subtrades, or what the forms of their contracts are and that they will therefore not be able to give the subtrade the required notice, will simply mean that a variation in the contract between contractor and subtrade will not release the surety. If in a particular case, or as a matter of general practice, the surety wishes to protect himself against such possible variations, he can always take steps to obtain the names of the subtrades from his principal. If he does this and then sends out the necessary notice to the subtrades,[12] he is protected against alterations in the contractor's obligations for labour and material.

It could be argued that if the surety decides he wishes to protect himself against variations in the contracts between his principal and the subtrades, the surety ought to be required only to take reasonable care to give the prescribed notice to the subtrades and not to be under an absolute duty to do so. The principal might, for example, deliberately not disclose the identity of certain of his subtrades. This is not likely to occur unless the principal is bent on some kind of fraudulent activity and in that case the Commission believes the surety, as guarantor of his principal, should take the consequences of subtrades not having received the prescribed notice, rather than the subtrades themselves.

The scheme the Commission proposes for dealing with variations in the contracts between the principal and the subtrades is, we believe, not unduly harsh on the surety where the variation is necessary for the principal to carry out the original terms of his contract with the owner. But where the variation is precipitated by a variation in the contract between the owner and the principal, the situation is different. The point may be demonstrated by bearing in mind that a

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7 of Barren County 111 S.W. 686, 33 Ky. Law Rep. (1908), in which, during the course of construction of a school building, it was discovered that the plan of a gable would not harmonize with the rest of the building. An agreement to change the plan of the gable was held not to discharge the surety. The Court said: "In all building contracts such slight modifications as this must be presumed to be within the contemplation of the contracting parties. The difference in the plans was not so great as to be beyond such changes as the parties should reasonably have contemplated." It would, however, be unsafe to rely on such a doctrine given the present state of Canadian authority on the point.

12. Unless they are evidently unsubstantial, in which case even under the general law of suretyship, the surety is not discharged.

labour and material payment bond will only be issued if a performance bond has been issued. Thus, much of the reason why a bonding company is not concerned to approve each subcontract and contract for the supply of materials may be that the surety has already had a chance to judge the scope of the contractor's undertaking and the approximate amount of labour and material he will require at the time he issued the guarantee of performance. The surety therefore issues the labour and material payment bond on the understanding that the obligations the principal will incur in respect of labour and material are based on these required to carry out the contract with
the owner.

If therefore a variation in the obligations of the contractor to his subtrades is made as a result of a variation in the prime contract, the Commission believes it would not be right to impose the same limit on the surety as to the circumstances in which he may raise the defence that he is discharged by a variation in the obligations guaranteed by the labour and material payment bond.

In this case, unless the variation in the contract with the subtrade is unsubstantial or has been approed by the surety, or unless the variation in the prime contract is unsubstantial or has been approved by the surety, the surety should be discharged in accordance with the general law of suretyship.

If any one of the four alternatives referred to is satisfied, this should prevent the surety being discharged from his obligation to the claimants. This is obvious where the variation in the claimant’s contract is unsubstantial or has been approved. Where a variation in the prime contract has been approved by the surety, it should also follow that the approval extends to variations in contracts with subtrades consequent upon the approved variations in the prime contract; and where the variations in the prime contract, though not approved, are unsubstantial, it should again follow that variations in contracts with subtrades consequent upon the unsubstantial variations in the prime contract should not be any cause for concern to the surety, even though they might be quite significant in relation to the original obligations of the particular contract with the subtrade.

The one outstanding situation which may allow the surety to claim discharge and may therefore deprive a claimant of his security, is the case where there is a material change in the subtrade's contract consequent upon a material change in the principal's contract, neither of which has been approved by the surety. What is to happen in this situation?

The issue raised by this question is really a more general one. What is to happen if, despite the precautions we propose, the claimants lose their security because the surety has a successful defence? Where this occurs, the Commission believes that, as a general principle, it is essential to ensure that the owner is not made liable if, in reliance upon the absence of a statutory obligation to retain a holdback, he had in fact omitted to retain one. If, in such a case, the owner were fixed with liability, the policy underlying the bond alternative would be placed in jeopardy since the owner would want to safeguard his position by retaining a holdback of 15 per cent from the contractor, and the position with regard to the flow of funds would, as between owner and contractor, be the same as it is under the present law.

In the situation, hopefully rare, now under consideration, the Commission believes that as long as the owner is not at fault and he bona fide believed that a valid and sufficient guarantee had been provided, the best course is to recognize

that the statutory right of the lien claimants to a minimum level of security has disappeared.

Three mitigating qualifications can be made to this however. Firstly, before an owner is relieved of the obligation to retain a holdback and satisfy lien claims, he should be required to take reasonable care to ensure that a valid labour and material payment bond in proper form has been obtained; secondly, if the bond turns out to be invalid through no fault of the owner, the lien claimants should still be allowed access to the sum that is in fact retained by the owner from the contractor, even though there was no statutory obligation on the owner to retain such a sum. The position as to any such sum so retained by the owner would be analogous to the position of any sum retained by the owner in excess of 15 per cent of the value of the work done under the present law. It would therefore be subject to the owner's right of set off to complete the improvement.

Thirdly, when the result of the owner's failure to obtain the approval of the surety to a material change in the prime contract is that the surety is discharged from his liability to claimants under the labour and material payment bond, it seems unfair to the claimants that they should be without remedy against the owner. If there is no holdback bond, the claimants can look to the owner's holdback for payment. If there is such a bond, they lose that right. It seems to the Commission therefore that if the right to look to the owner to satisfy liens never comes into being because there is a holdback bond, but then the owner causes the claimants to be deprived of the protection of that bond by his failure, in varying his contract with the principal, to follow the necessary procedure vis a vis the surety, the owner should be responsible to the claimants.

It should be made clear that in this situation the liability to which the owner would be subjected is not for the full amount for which the surety would have been liable if he had not been discharged, but the amount for which the owner would have been liable if he had been required to retain a holdback but had simply failed to do so. in addition, as a warning of this responsibility that we propose should attach to the owner, all labour and material payment bonds, issued in holdback form and intended as an alternative to the statutory holdback, should contain a statement in reasonably sized print. The statement should be headed in large capital letters which read "IMPORTANT WARNING: LIABILITY UNDER THE MECHANICS'LIEN ACT." Immediately below this heading the statement should say:

> Every intended modification or variation in the contract between the principal and the obligee must be communicated to the surety before any work is done or any preparations made in respect of the modification. Any intended extension in the time for completion or in the place of performance should also be communicated before it is agreed to. Failure to comply with this warning may result in the surety's discharge from obligation under this bond and any performance bond that has been issued and will also result in substantial liability on the part of the owner-obligee under the *Mechanics' Lien Act*.

The statement should appear in the upper half of the first page of a labour and material payment bond in holdback form, either at the very top or between the bonding company's name and the heading "Labour and Material Payment Bond in Holdback Form," or immediately below that heading. The whole statement should be contained in a box, the outline of which is red in colour.

In proposing the requirement that the surety ensure that a labour and material

payment bond it issues in holdback form contains the red warning light described above, the Commission does not regard it as necessary to set out a procedure and a timetable for obtaining or being denied approval of the intended variation. Although this was suggested in relation to variations as between contractor and subtrades, in the case of an intended variation as between owner and contractor the notice of intended variation is likely to be of much more immediate concern to the surety and to require, and command, his immediate attention. Statutory procedures may therefore be dispensed with.

If, after all these efforts to protect claimants, it still appears that the surety is discharged without responsibility on the part of the owner, the Act should then provide that the owner is not liable to lien holders for sums advanced bona fide to the contractor. A provision similar to the present section 21(3) of the Act is required. That subsection provides:

> All payments up to eighty-five per centum of the value of the contract or the work, services, or materials as calculated under subsection (1), made in good faith by an owner, contractor, or subcontractor to any person entitled to file a claim of lien, shall operate as a discharge *pro tanto* of any such lien.

In the context of the holdback bond situation, where the owner bona fide believed that a valid and sufficient labour and material payment bond in holdback form had been issued and he took reasonable care to ensure that it was valid, this subsection should apply with the modification that the *pro tanto* discharge should be up to 100 per cent of the value of the work done, rather than 85 per cent. The result is that if the holdback bond is valid, or if the surety is discharged through the fault of the owner, lien holders will be entitled to judgment for whatever sum they would be entitled to under the separate holdback scheme. If the surety is discharged without responsibility on the part of the owner, lien holders will be entitled to judgment for the *de facto* amount of the owner's holdback, subject to the owner's right of set-off for any additional cost of completion.

The mechanism for dealing with liens that have been filed in a situation when the holdback bond is void without responsibility on the part of the owner poses a problem. It may require a trial to determine whether the bond is invalid or whether the owner is at fault. The sum for which lien holders are entitled to judgment will be one amount if either the bond is valid or the owner is at fault, but possibly a different amount if neither of these points is established. The Commission believes that it would be wrong to allow the owner to remove the liens on payment into court of the amount of his de facto holdback merely on the assertion of invalidity of the bond or of absence of fault on the owner's part. Until therefore it is accepted by the lien claimants or declared judicially that the holdback bond is invalid and the owner not at fault, the liens may only be removed by payment into court of 15 per cent of the value of the work done.[13]

In the last resort it is again the attitude of the bonding companies that will prove crucial. If they adopt a practice of resisting claims under the modified form of labour and material payment bond we propose on the basis of a variation in the obligations that are guaranteed, members of the construction industry and their advisers will form their own judgment as to the efficacy of the bond alternative and may well conclude that they prefer the holdback and lien system after all.

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13. Or more if the owner has in fact held more back, or less if the lien claims are for less than this sum.

6. The Position of Lien Claimants under the Bond Alternative

The position of lien claimants, where the contractor has provided a holdback bond and the owner has retained no holdback, is likely to be substantially better than it is under the present provisions of the Act. Administratively, their position will be unchanged as far as the filing of liens is concerned. They will file in the normal way. Assuming again it is the contractor who has obtained the bond and the lien claimants are subcontractors employed by the contractor, the only difference as far as removal of the liens is concerned is that the owner will have a contractual right to compel the bonding company to do it promptly. This is not of course a matter which affects the position of the lien claimants.

The advantage to the lien claimants will lie in the fact that if our proposal is accepted by the legislature and adopted by the industry, the lien claimants will also have claims against the surety directly for amoupts over and above what they are able to claim under the Act in its present form. This will not be a new element in the type of project in which the parties usually obtain labour and material payment bonds at the present time. But both in these latter types of projects and in projects where bonding is used as an alternative form of security, there should also be advantages in terms of the flow of funds along the construction chain.

The disadvantage to the lien claimants is the possibility that the surety and the owner might both be able to avoid liability to the lien claimants. We believe, however, that our proposal embodies every reasonable safeguard against such an occurrence.

7. The Operation of the Bond Alternative along the Construction Chain

It has been assumed so far that the party obtaining the bond is the contractor and the party relieved of a statutory obligation to retain a holdback is the owner. In principle the scheme operates in exactly the same fashion further down the construction chain. Thus, under the separate holdback scheme we have recommended, the contractor is required to retain a holdback from his subcontractors in order to guard against the risk of lien claims arising under these subcontractors. If one of the subcontractors obtains a labour and material payment bond in the requisite form, the contractor will not be required to retain a holdback from that subcontractor. If liens are filed by people employed by that subcontractor, the surety will be contractually obligated to the contractor to remove the liens.

The operation of the bond alternative at this level is quite independent of its operation at the level of the contractor and owner. Thus, there would be nothing in principle to prevent a subcontractor obtaining a bond even though the contractor had not done so. In that case the owner will have retained a holdback from the contractor, but the contractor will not be required to retain one from the subcontractor. In the opposite situation where the contractor has obtained a bond, but not the subcontractor, the owner will be under no obligation to retain a holdback from the contractor, but the contractor will be required to retain one from the subcontractor.

8. Who May Provide the Holdback Bond?

In order to ensure that lien claimants are not deprived of the protection given to them under the present law by the incursion of unreliable sureties, the Commission believes that there should be some form of regulation as to who may

undertake the obligations of a surety where the security provided is intended to operate as an alternative to the holdback system. We do not propose in this Report to specify the form which that regulation should take, nor the scheme by which it should be administered. This can best be done by regulations made under the Act. We propose, however, that steps be taken to ensure that no one may provide the modified labour and material payment bond intended as an alternative to the holdback unless he is appropriately certified in accordance with regulations made under the Act.

9. Who May Sue Upon a Labour and Material Payment Bond?

Normally the contractor purchases a labour and material payment bond from the surety and the bond consists of a covenant given by the surety and the contractor to the owner to the effect that the covenantors will stand liable to pay up to a certain sum of money. The bond then provides that if the contractor pays the full price of all his labour and material, the covenant will be void; but if the contractor does not so pay, persons who supplied labour and material and who contracted directly with the contractor shall be allowed to sue the surety for the amount by which they are unpaid, always provided that the surety's liability is not to exceed the amount he covenanted to pay.

The persons who contracted directly with the contractor are his suppliers and subcontractors. They therefore fall within the terms of such a bond, but sub--subcontractors do not. However effective the protection given by a bond to the contractor's suppliers and the subcontractors, the last mentioned classes do not fall within that protection and their position therefore needs to be considered separately.

Is the right to sue given to the contractor's suppliers and the subcontractors effective? At common law, it is doubtful whether it would be, since they are not parties to the deed. This difficulty has already been foreseen and dealt with, however, by section 2(39) of the *Laws Declaratory Act*, R.S.B.C. 1960, c. 213, which provides:

> A claimant under a labour and material bond has a cause of action against the surety named in the bond in the event that the principal named in the bond defaults in his obligations thereunder, and may commence an action against the surety on his own behalf and on behalf of other claimants to recover the amount of the claim or claims.

If the *Mechanics' Lien Act* is amended so as to provide that a labour and material payment bond may be an alternative to the lien and holdback system, this provision should be transferred to the *Mechanics' Lien Act*.

The Commission recommends:

1. *Where a contractor or a subcontractor obtains a labour and material payment bond in holdback form, the person employing the contractor or subcontractor, as the case may be, should be under no statutory obligation to retain a holdback in respect of work done or materials supplied the payment for which is provided for in the bond; and only moneys in fact retained will be subject to a lien or charge and such lien or charge will be postponed to the right of the person retaining such moneys to set off against them any amount additional to the original contract price necessary to complete the original contract in respect of which the moneys were retained.*

2. *In these recommendations:*

   (a) *A labour and material payment bond in holdback form is an instrument or obligation binding on a surety whereby*

(i) on the failure of the principal to discharge a debt to a claimant, the surety is liable, up to an amount of not less than 50 per cent of the contract price of the contract between the principal and the obligee, to discharge that debt, and

(ii) on the failure of the principal to cancel or discharge, within seven days from the date of filing, a lien filed in the manner provided in the Act, the surety is liable, up to an amount of not less than 50 per cent of the contract price of the contract between the principal and the obligee, to cancel or discharge that lien within fourteen days from the date on which it was filed

provided that the total liability of the surety under a labour and material payment bond in holdback form need not exceed 50 per cent of the contract price of the contract between the principal and the obligee.

(b) "principal" refers to a contractor or subcontractor who obtains a labour and material payment bond in holdback form;

(c) "surety" refers to the person liable on the default of the principal under a labour and material payment bond in holdback form;

(d) "claimant" refers to a person who contracts with a principal for the doing of work or for the supply of materials;

(e) "obliges" refers to a person who engages a principal in connection with an improvement.

3. Where the cost to the principal of discharging a lien would be less than the cost to some other party, the liability of the surety under the labour and material payment bond in holdback form need only extend to the lesser cost in order for recommendation (2)(a)(ii) to be satisfied.

4. Subject to recommendation 5, where, as a result of a variation in the contract between the principal and a claimant, the liability of the surety to the claimant would be discharged under the general law relating to suretyship, the surety should continue liable unless

(a) before the claimant agreed to the variation he had been given notice by the surety that any proposed variation in the contract between the claimant and the principal should be communicated to the surety, and

(b) either the claimant failed to communicate the proposed variation to the surety or the surety informed the claimant, within ten days of receiving notice of the proposed variation, that the surety refused to guarantee payment by the principal in relation to the proposed variation.

5. Subject to recommendation 7, where, as a result of a variation in the contract between the principal and a claimant, the liability of the surety to the claimant would be discharged under the general law relating to suretyship and the variation is made consequent upon, or in accordance with, a variation in the contract between the obligee and the principal which would under the general law of suretyship discharge the surety from liability in respect of a guarantee of the principal's obligations to the obligee, and the surety has not consented to either variation, the purety should be discharged from liability to the claimant under a labour and material payment bond in holdback form, but unless these conditions are satisfied the surety should continue to be liable to the claimant under the bond.

6. Every instrument intended to or represented to be or purporting to be a labour and material payment bond in holdback form should contain the following statement:

"IMPORTANT WARNING: LIABILITY UNDER THE MECHANICS' LIEN ACT

"Every intended modification or variation in the contract between the principal and the obligee must be communicated to the surety before any work is done or any preparations made in respect of the modification. Any intended extension in the time for completion or in the place of performance should also be communicated before it is agreed to. Failure to comply with this warning may result in the surety's discharge from obligation under this bond and any performance bond that has been issued and will also result in substantial liability on the part of the owner-obligee under the Mechanics' Lien Act."

The statement should appear in the upper half of the page of such an instrument, either at the top of the page, or under the surety's name or under the description of the instrument and the statement should be contained in a box, the outline of which is red in colour.

7. *Failure to comply with the previous recommendation should disentitle the surety from raising in any court of law the defence that he is discharged from liability under a labour and material payment bond in holdback form by reason of a variation in the obligation guaranteed.*

8. *When an instrument intended to be or represented to be or purporting to be a labour and material payment bond in holdback form is unenforceable or fails to satisfy the requirements of recommendation 2 (a)*

   (a) *owing to the provisions of recommendation 5, the obligee shall be subject to the same liability as if he had not been excused by recommendation 1 from the obligation to retain a statutory holdback, or*

   (b) *for any reason other than the provisions of recommendation 5, the obligee shall be excused from the obligation to retain a statutory holdback and the provisions of recommendation 1 shall apply, providing that the obligee had a reasonable and honest belief that the principal had obtained a labour and material payment bond in holdback form in accordance with the terms of recommendation 2 (a).*

9. *Section 2(39) of the* Laws Declaratory Act*, R.S.B.C. 1960, c. 213, dealing with the liability of a surety to claimants, should be contained in the* Mechanics' Lien Act.

10. *Machinery should be established for determining what persons or corporations are entitled to issue labour and material payment bonds in holdback form so as to relieve the obliges from the duty to retain a holdback.*

CHAPTER IX THE TRUST

1. General

Section 3(1) of the Act provides as follows:

> All sums received by a contractor or subcontractor on account of the contract price are and constitute a trust fund in the hands of the contractor or of the subcontractor, as the case may be, for the benefit of the owner, contractor, subcontractor, Workmen's Compensation Board, workmen, and materialmen; and the contractor or the subcontractor, as the case may be, is the trustee of all such sums so received by him, and, until all workmen and all materialmen and all subcontractors are paid for work done or materials supplied on the contract and the Workmen's Compensation Board is paid any assessment with respect thereto, shall not appropriate or convert any part thereof to his own use, or to any use not authorized by the trust.

A trust provision was first introduced into the law of British Columbia in 1948. It first appeared as section 18A[1] of the Act, and in the 1948 Revision, it became section 19.[2] Since the Act was consolidated in 1956[3] it has appeared as section 3(1), and is now to be found in the 1960 revision.[4]

The intention of this provision is to secure to the classes of persons described in the subsection a measure of protection additional to that provided by the ordinary law of contract and by the right, where it exists, to obtain a lien against the owner's interest. The device used to create the additional measure of protection is to make certain classes of persons owners in equity of contract moneys and to give them the rights which the beneficiaries under a trust have against a trustee and anyone into whose hands trust property comes.

A trust provision was first adopted in Manitoba in 1932, followed by Ontario in 1942, and New Brunswick enacted the trust provision in 1959. There was little litigation on these various provisions in the early years of their existence, but over the last 10-15 years there has been extensive litigation, particularly in British Columbia and Ontario. In this time, a number of uncertainties concerning the operation of the trust provision have been revealed. Some of these uncertainties have been resolved by judicial interpretation. others remain.

The Buchanan Report on the *Alberta Act*, and the Themson Report on the *Saskatchewan Act*, both recommended against the introduction of the trust provision into the legislation with which they were concerned.

2. Should the Trust Provision Be Retained?

In the working paper, the Commission pointed out that there had been a considerable amount of litigation concerning the trust provision, often of a

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1. *See* the *Mechanics' Lien Act Amendment Act*, S.B.C. 1948, c. 48, s. 2.

2. *See* the *Mechanics' Lien Act*, R.S.B.C. 1948, c. 205.

3. *See* the *Mechanics' Lien Act,* S.B.C, 1956, c. 27.

4. *See* the *Mechanics' Lien Act*, R.S.B.C. 1960, c. 238.

lengthy and complicated nature. But the Commission suggested no recommendation at that time on points of principle. Instead the Commission invited submissions from the community and from lawyers. On the basis of these submissions, the Commission does not feel that the repeal of the trust provision should be recommended. The Commission has discovered no evidence to suggest that the existence of a trust is increasing the difficulties of contractors and subcontractors in obtaining credit facilities from lending institutions. Moreover, the trust does conform to the general policy of the Act in trying to keep contract moneys within the framework of the parties to the contract, and it does not appear to cause any additional slowing down of the flow of funds along the construction chain.

The Commission recommends:

Retention of the trust provision, but with certain changes in its operation.

3. Analysis of and Recommendations for Change in the Trust Provision

(a) *Relationship between the trust provision and the lien and holdback provisions*

(i) *No lien filed*

In *Minneapolis-Honeywell* v. *Empire Brass*[5] it was argued that where a potential lien claimant had failed to file his lien within the time limited for filing, not only did the lien claimant lose the right of lien, he also lost the rights conferred upon him under the trust provision. The Court of Appeal of British Columbia[6] held that the right to assert the existence of a trust was limited to persons who held valid claims of lien, but the Supreme Court of Canada rejected this idea and held that the rights of the trust beneficiary were unimpaired by the lapse of the right to claim a lien. Rand J., giving the judgment of the majority, said:

> I am unable to feel difficulty about what this language provides. The Act is designed to give security to persons doing work or furnishing materials in making an improvement on land. Speaking generally, the earlier sections give to such persons a lien on the land, but that is limited to the amount of money owing by the owner to the contractor under the contract when notice of the lien is given to him. Only thereafter does he pay the contractor at any risk. For obvious reasons this is but a partial security; too often the contract price has been paid in full and the security of the land is gone. It is to meet that situation that section 19 [the trust section, now section 3] has been added. The contractor and subcontractor are made trustees of the contract moneys and the trust continues while employees, materialmen or others remain unpaid.

Rand J. held that the plaintiffs were entitled to be treated as trust beneficiaries despite their failure to file a lien. It is therefore settled law that the object of the trust provision is to provide protection to trust beneficiaries independent of the protection provided by the existence of the right to claim a lien.

The Commission agrees with this view. One of the most obvious situations in which the trust provision may give protection is where the right to file a lien has lapsed.

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5. [1955] S.C.R. 694; [1955] 3 D.L.R. 561 (S.C.C.)

6. [1954] 4 D.L.R. 800

The Commission recommends:

The right to assert the existence of a trust should continue to be unaffected by the fact that the time limited for filing a lien has expired.

(ii) *No lien exists*

Section 4 of the Act provides:

> Nothing in this Act extends to a highway or to any improvement done or caused to be done thereon by a municipal corporation.

This section has already been discussed in connection with the lien and holdback provisions. It also raises a problem in connection with the trust. Read literally, it would mean that no trust of contract moneys was created in a case where the improvement concerned a highway. But the Supreme Court of Canada in *Canadian Bank of Commerce* v. *T. McAvity and Sons Ltd.*[7] held that the identical wording in the *Ontario Act*[8] did not exclude the operation of the trust in the case of highways. The Commission believes that the result of this decision is sound. The reason for excluding certain classes of property from the operation of the lien provision is that a right of sale in respect of these classes of property would not be desirable. But the trust provision involves no right of sale, and therefore need not be excluded in the case of the specific types of property in question.

The decision of the Supreme Court of Canada, whilst sound in principle, is hard to justify on the present wording of the Act. This therefore appears to be one of these instances where the statute should be amended to bring it in line with the law.

The Commission recommends:

Section 4 be amended so as to make it clear that the operation of the trust is not excluded.

(b) *The time and manner of creation of the trust*

The operative words of section 3(1) are as follows:

> All sums received by a contractor or subcontractor on account of the contract price are and constitute a trust fund in the hands of the contractor or of the subcontractor, as the case may be ... and the contractor or the subcontractor, as the case may be, is the trustee of all such sums so received by him ...

These words designate the moment of receipt of contract moneys as being the time and manner of creation of the trust. Several problems have arisen concerning the interpretation of this provision. It is clear that the owner can never be a statutory trustee within the meaning of section 3(1). As long as the owner retains dominion over and possession of contract moneys, no trust attaches. It is also clear that once the moneys are in the hands of the contractor, the trust is duly constituted. But there are several intermediate possibilities around which difficulties of interpretation have occurred. These will be dealt with in turn.

7. (1959), 17 D.L.R. (2d) 529

8. *Mechanics' Lien Act*, R.S.O. 1950, c. 227, s. 2, now repealed.

(i) __*Garnishment*

A creditor who has obtained judgment against his debtor, or who has an action pending against his debtor may attach debts owed to the judgment debtor.[9] In order to take advantage of this right, the judgment creditor obtains a garnishing order that all debts owed by a certain person (the garnishee) to the judgment debtor shall be attached and shall be paid into court in satisfaction of the judgment. The basic rule of obtaining execution however is that: "Execution is subject to the fundamental principle that the judgment creditor is in no better position than the judgment debtor so far as the rights of third parties are concerned and does not acquire a title to moneys or the proceeds of sale belonging to third parties or subject on their behalf to liens, charges or other interests."[10]

The problem created by the right to obtain a garnishing order in the context of the trust provisions of the Act is this: if a judgment creditor of a contractor obtains a garnishing order against an owner, thereby attaching a debt due from the owner to the contractor, does the judgment creditor receive the sum attached free from, or subject to the trust?

The argument for saying he takes free of the trust is that the trust only attaches where money is "received" by the contractor. If the judgment creditor obtains payment directly from the owner, the contractor never receives it, and hence the event required to bring the trust into being never occurs. The argument for saying that the judgment creditor receives the sum attached subject to the trust is that, in accordance with the fundamental rule, the judgment creditor can have no better right than the judgment debtor has, and since the judgment debtor can never obtain the money free of the trust, it follows the judgment creditor takes subject to the trust.

In *Castelein* v. *Boux*,[11] by a hare majority of three to two, the Manitoba Court of Appeal held that where money was owed by an owner to a contractor, and a judgment creditor of the contractor issued a garnishee summons against the owner, the creditor was entitied to receive payment of the money owod to the creditor free of the trust which would attach if and when the contractor received payment. The majority held that the trust did not come into being until contract money was "received" by the contractor and since the offect of the garnishee order was that the money would never bo received by the contractor, the trust never attached to the contract money. The dissentients on the other hand felt that the judgment creditor could not stand in any better position than the judgment debtor would have done vis "a vis the debt, and since the judgment debtor could only receive it subject to the rights of trust beneficiaries, so must the judgment creditor. As Robson, J.A. put it (with whom Dennistoun, J.A. concurred):

> The test in garnishee issues where there are third party claims is the one found in the general rule that applies to all classes of execution, namely, can the debtor honestly deal with the debt or property as his own, without violation of the rights of others? *Campbell* v. *Gemmell* (1890), Yan. R. 355; *Stobart* v. *Axford* (1893), 9 Man. R. 18, at p. 21.

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9. *See Attachment of Debts Act*, R.S.B.C. 1960, c. 20, s. 3.

10. Crossley Vaines on Personal Property, 4th ed. 1967, p. 437, citing *Re Standard Manufacturing Co.*, (1891) 1 Ch. 627; *Re Opera Ltd.*, (1891) 3 Ch. 260; *Jennings* v. *Mather* (1902) 1 R.B. 1.

11. (1934) 3 D.L.R. 351 (Man. C.A.)

In *Mike's Roofing & Insulation Ltd.* v. *Horden Schultz*,[12] C.C.J. followed the majority in *Castelein* v. *Boux*,[13] holding that moneys owed to a contractor by an owner-garnishee were not trust moneys and the plaintiff, a judgment creditor of the contractor, was entitled to payment out of the moneys paid into court under the attachment order.

The Commission believes that the result brought about by these decisions is inconsistent with the policy of the trust provision. With regard to the rights of the trust beneficiary, the trust provision draws a clear distinction between the position of the owner on the one hand and the contractor and subcontractor on the other. But in order to prevent that distinction from being circumvented, it is necessary to eliminate the availability of a procedure which, though nominally against the owner is in substance aimed at recovery from the contractor. If it is accepted that the contractor's and subcontractor's right of disposal of contract moneys should be subject to a trust, logic requires that the right of execution of a judgment creditor of the contractor or subcontractor be tailored to accord with the existence of the trust. Under the present law, the judgment creditor has a better right against the owner-garnishee than he would have against the contractor or subcontractor who is indebted to him. The effect of the existence of such a right is to defeat the policy of the trust provision.

The Commission recommends:

Where moneys owing to a contractor or subcontractor would, if paid to the contractor or subcontractor, be subject to a trust under section 3(1) of the Act, such moneys shall not be subject to attachment under the Attachment of Debts Act*, R.S.B.C. 1960, c. 20.*

(ii) *Payments to a trustee in bankruptcy*

A problem similar to that caused by the issue of garnishment proceedings may arise in relation to payments of contract moneys owed to the contractor and made by the owner to the contractor's trustee in bankruptcy. Have such payments been "received" by the contractor so as to render them subject to a trust, or does the trustee in bankruptcy take free of the *Mechanics' Lien Act* trust?

In *Re Walter Davidson*[14] the owner, after satisfying lien claims, paid the balance of moneys owing to the contractor to the contractor's trustee in bankruptcy. There were however a number of unpaid subcontractors who had supplied materials and services on the project and who did not have valid claims for liens. These subcontractors asserted that the trustee in bankruptcy was not free to apply the contract moneys received from the owner to the claims of the general creditors of the contractor, but must hold these funds subject to a trust in favour of the subcontractors. The trustee in bankruptcy applied to the Ontario Supreme Court in bankruptcy for directions. For the general creditors it was argued that since, on the date of the bankruptcy, the moneys had not been "received" by the contractor, no trust had attached by that date. After that date, no trust was capable of attaching since the creditor's right had already crystallized. Consequently, it was argued, the moneys owing to the contractor fell into the estate of the contractor and were available for distribution amongst the general creditors. Smily J., citing *Minneapolis-Honeywell* stated that he understood Rand, J. to be "saying, in effect, that

12. (1965) 46 D.L.R. (2d) 595 (Co. Ct., B.C.)

13. *Supra*

14. (1957), 10 D.L.R. (2d) 77

moneys paid on account of the contract are subject to or impressed with the trust whether or not they are actually, that is physically received by the contractor or subcontractor." The learned judge concluded: "It seems clear therefore that this money is not the property of the bankrupt which is divisible amongst its general creditors under the *Bankruptcy Act* R.S.C. 1952, c. 14, at least until the beneficiaries under the trust are paid."

This decision is in line with the general policy of keeping contract moneys within the construction chain.

The Commission recommends:

No change be made in the Act with regard to priorities as between the trustee in bankruptcy of a trustee under section 3 and a beneficiary of the trust on the basis that the present law provides that the trustee in bankruptcy who receives moneys, which are earned in respect of an improvement, from the owner, receives them subject to the trust.

(iii) *Assignment*

It is common practice for a person who borrows money to make assignment of present or future accounts as security for the loan. Again, someone who wishes to keep open a line of credit with his supplier may be required to make an assignment of accounts as security for the sum owed to the supplier. Where a contractor or subcontractor makes an assignment of a construction contract debt, the problem of priorities as between trust beneficiary and assignee arises. If the debtor is the owner and the contractor makes an assignment to a third party, is the subject of the assignment trust moneys in the hands of the assignee or does it escape the trust provision on the ground that the contractor has never "received" the money within the meaning of the trust provision?

One of the earlier cases to go to the Supreme Court of Canada on this problem was *Minneapolis-Honeywell Regulator Co. Ltd.* v. *Irvine and Reeves Ltd.*[15] is in that case a subcontractor entered into contracts to install heating systems on four projects, each with a different general contractor. The defendant was a plumbing and heating wholesaler and supplied the main requirements of the subcontractor both generally and in connection with the four particular projects. The subcontractor was indebted to the supplier by almost $20,000. The supplier, being concerned about the indebtedness, persuaded the subcontractor to make a general assignment of present and future book accounts to secure the sum then owing. The supplier then gave notice of the assignment to the various general contractors and moneys owing to the subcontractor, both generally and on the four particular projects, were thereafter paid in the form of cheques payable jointly to the subcontractor and supplier. The plaintiff was engaged by the subcontractor to do a portion of the work in connection with the four particular projects. Eventually, the subcontractor went into liquidation at which time he was still indebted to the plaintiff in respect of the plaintiff's work on the four projects. The plaintiff now claimed that money received by the defendant supplier by way of assignment was trust money to be held for the benefit of the plaintiff in so far as it was paid by the general contractors of the four particular projects on which the plaintiff had been engaged.

Thus, the question was whether or not moneys, owed to a subcontractor and paid to the subcontractor's supplier under the assignment constituted trust moneys in the hands of the supplier.

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15. [1955] S.C.R. 694; [1955] 3 D.L.R. 561

Davey J.[16] and the Court of Appeal[17] thought they did not. As the Act was organized at this time, section 19 was the trust section and section 16 provided: "No assignment by the contractor or any subcontractor of any moneys due in respect of the contract shall be valid as against any lien given by this Act." Davey, J. remarked in the course of his judgment:[18]

> The Legislature when enacting s. 19 did not extend s. 16 by providing that no assignment should be valid against any trust set up by the new section, as I think it would have done if that had been its intention."

The Supreme Court of Canada disagreed with this view. Rand, J. said:[19]

> ... I cannot interpret the word "received" in s. 19 as not including money paid to an assignee. The money 'received' on account of the contract is the same as that paid by the contractor: payment the correlative of receipt. The assignee acts through the right and power of the assignor; and the receipt by him is likewise that by the creditor. If this were not so, the entire purpose of the section could be nullified by an assignment contemporaneous with the contract ... I have no doubt that no assignment can destroy the rights created by s. 19 in the moneys so paid over."

In addition to this decision of the Supreme Court of Canada, an amendment has soon introduced into the *British Columbia Act*. Section 16, the section which previously dealt with the priority of liens, has been reworded and has become section 19(1). It now reads:

> No assignment by the contractor or subcontractor of any moneys due in respect of the contract is valid as against any lien or trust created by this Act.

Since the decision in the *Minneapolis-Honeywell*[20] case there have been many subsequent decisions that have affirmed the principle that an assignee of moneys takes subject to a trust which would attach to these moneys in the hands of the assignor. The Commission agrees with this position. The general policy of the trust provision is to keep contract money within the construction chain. To allow assignees of contract moneys to retain these moneys free of the trust would offer a ready opportunity of defeating policy of the trust provision.

The Commission recommends:

A provision similar to the present section 19 (1) be retained, according to which "no assignment by the contractor or subcontractor of any moneys due in respect of the contract is valid against any ... trust created by this Act."

(iv) *Repayment of loans obtained for the purpose of financing an improvement*

The general policy of the trust provision is to prevent people in the construction chain from diverting contract moneys to a use unconnected with the

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16. [1954] 1 D.L.R. 678

17. [1954] 4 D.L.R. 800

18. *Supra*, p. 68.

19. [1955] 3 D.L.R. 561 at p. 562

20. *Supra*

construction project. A consistent recognition of that policy requires that devices such as garnishment and assignment not be allowed to defeat the trust. But at the same time, care must be taken to ensure that the operation of the trust is not made so rigid that a statutory trustee can never obtain finance because the incidence of the trust makes the risk of lending to him too great.

A situation that has occurred from time to time, and will no doubt continue to occur, is one in which the contractor wishes to pay his subcontractors, but he has not yet received sufficient money from the owner to do this. The contractor then obtains a loan from his bank to pay the subcontractors. The expectation of the parties here is that when the owner eventually pays the contractor, the contractor will pay off his debt to the bank. If, in this situation, there are still some unpaid trust beneficiaries, they might wish to claim as trust moneys the moneys received by the bank. The Commission believes that in this situation, to the extent that the money received by the bank represents repayment of a loan made to inject money into the construction chain, the bank ought to be able to retain that money free of the trust imposed by section 3.

The present law on this subject is quite complex. The leading case is *John M. M. Troup Ltd.* v. *Royal Bank of Canada.*[21] The general principle contained in this case is that where a bank receives money in good faith from its customer in the ordinary course of business with no notice of any actual or intended breach of trust, the bank may appropriate the moneys received to the customer's debt, and the fact that the moneys were in fact trust moneys in the hands of the contractor does not affect the position of the bank. This principle is part of the general law of banking and as such warrants no separate treatment in the *Mechanics' Lien Act.*

In the working paper, the Commission had tentatively recommended that where a person lends money for the financing of a particular building project and receives an assignment, from the borrower, of contract moneys payable or to become payable to the borrower, the lender should be entitled to retain these contract moneys, up to an amount equal to the sum lent for the purpose of the particular project, in priority to the trust beneficiaries.

A similar provision is contained in the Ontario Act. Section 2(6) of that Act states:

> Notwithstanding anything in this section [the trust section], where money is lent to a person upon whom a trust is imposed by this section and is used by him to pay in whole or in part for any work done, for any materials placed or furnished or for any rented equipment, trust moneys may be applied to discharge the loan to the extent that the lender's money was so used by the trustee, and any sum so applied shall be deemed not to be an appropriation or conversion to the trustee's own use or to any use not authorized by the trust.

The Commission recommends:

The Act should contain a provision similar to section 2(6) of The Mechanics' Lien Act*, S.O. 1968-69, c. 65.*

(c) *The limitation period*

There is at present no limitation period provided in the Act for the enforcement of the trust provision. The effect of this is presumably that the

21. [1962] S.C.R. 487; (1962), 34 D.L.R. (2d) 556

provisions of the *Trustee Act*[22] and the *Statute of Limitations*[23] govern the period within which an action for breach of trust must be brought. The Commission believes that the rights provided by the Act require a special limitation period. These rights confer a special privilege. It is reasonable to ask of the recipient of that privilege that he bring his action promptly.

The *Ontario Act* has recently incorporated a special limitation period which deals with certain claims brought undor the trust provision. It provides in section 3 that:

> No action to assert any claim to trust moneys referred to in section 2 [the trust provision] shall be commenced against a person upon whom a trust section except,
>
> (a) in the case of a claim subcontractor in cases in clauses b, c, and d within nine months after the completion or abandonment of the contract or subcontract;
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> (b) in the case of a claim for materials, within nine months after the placing or furnishing of the last material;
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> (c) in the case of a claim for services, within nine months after the completion of the service; or
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> (d) in the case of a claim for wages, within nine months after the last work was done for which the claim is made.

The Commission feels that this provision does not go far enough. Firstly, it does not affect the limitation period for actions against the statutory trustees themselves. Secondly, it does not affect the limitation period for actions against parties into whose hands trust funds are alleged to come, if the indebtedness to which the trust funds have allegedly been appropriated arose as a result of the supply of goods or services.

In short, the provision only protects banks and other lending institutions.

In the working paper the Commission suggested that the period of limitation should, as in the *Ontario Act*, be nine months. In the light of submissions received, however, the Commission has decided to increase this period to one year. This decision is not the result of any major change of thinking as to policy. It simply reflects the fact that the year is a simpler figure and imposes perhaps less strain on the memory.

The Commission recommends:

There should be a limitation period of one year in respect of all claims by a beneficiary under the trust, and the period should run from the time of completion, abandonment, or other discharge of the contract, or of the completion or abandonment of the improvement, in respect of which the claim arose.

(d) *Payment to trust beneficiaries*

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22. R.S.B.C. 1960, c. 390, s. 93.

23. R.S.B.C. 1960, C. 370.

It was pointed out in connection with the payment of contract moneys to lien claimants that there is under the present law no requirement that the payee appropriate the contract moneys to the debt due on the job in respect of which the moneys were made available.[24] The Commission recommended that there should be an automatic appropriation in such circumstances. The Commission believes that the same appropriation should occur automatically in the case of trust funds, so that when a contractor pays a subcontractor out of contract moneys that have become available on a particular job, the payer's duties of trustee are *pro tanto* discharged. No further recommendation would be necessary to achieve this result, since the form of the recommendation made in connection with the payment of lien claimants[25] would bring about the result suggested here.

(e) *Relations between the trustee and beneficiaries inter se*

Most of the problems that may arise in determining the duties of the trustee to his beneficiaries and the method by which the trustee is able to discharge these duties remain unsolved. The main problem is the lack of guidance given in section 3(1) as to what exactly was intended. The persons designated trustees of contract moneys are the "contractor or subcontractor." The beneficiaries of the trust are "the owner, contractor, subcontractor, Workmen's Compensation Board, workmen, and materialmen." The most significant observation to be made about this is that the list of beneficiaries includes the trustees themselves and it includes one party who stands entirely outside the project viz. the Workmen's Compensation Board. Standing alone, that provision might create a difficulty in terms of establishing priority as between trustee-beneficiaries and non-trustee beneficiaries, quite apart from the fact that nothing is said as to ranking the different classes of beneficiaries. But in an apparent attempt to resolve that problem, the section goes on to provide that "until all workmen and all materialmen and all subcontractors are paid for work done or material supplied on the contract and the Workmen's Compensation Board is paid any assessment with respect thereto," the contractor or subcontractor "shall not appropriate or convert" any part of the contract moneys "to his own use, or to any use not authorized by the trust." The position of the subcontractor is remarkable. He is a trustee and a beneficiary. He is also told that subcontractors must be paid before he (the subcontractor) can appropriate any of the money. An alarming proposition.

In dealing with problems of garnishment, assignment and the trustee in bankruptcy, the Commission has sought to say something about the outer limits of the trust. The question under consideration now is that of the relations *inter se* between the various parties to the trust. There are several aspects of this difficult problem, however, which the Commission suggested is its working paper could suitably be the subject of recommendations. They include the problem of the relationship between the doctrine of privity of contract and the existence of a trust; and the problem of priorities as between trust beneficiaries.

The significance of the former matter lies chiefly in the decision of Dryer J. in *Crane Canada Ltd.* v. *McBeath Plumbing & Heating Ltd.*[26] In that case, his lordship, following the

24. *Supra*, p. 75

25. *Ibid*

26. (1965), 54 W.W.R. 119 (B.C.S.C.)

judgment of the Court of Appeal of Manitoba in *Royal Bank* v. *Wilson*,[27] hold that the trust created by section 3(1) applies for the benefit of beneficiaries who contract directly with the person alleged to be trustee, but not for the benefit of persons who claim under the person who contracted directly with the person alleged to be trustee. Thus, if the contractor holds contract moneys on trust, the beneficiaries are the subcontractors and suppliers he employed, but not the sub-subcontractors and the suppliers employed by the subcontractor. Correspondingly, once the trust moneys come into the hands of the subcontractor, a trust attaches in favour of the subsubcontractors and suppliers employed by the subcontractor. The situation might aptly be summarized as one of "privity of trust."

The Commission feels that the principle of pavity of trust, in the context of the *Mechanics' Lien Act*, is a sound one. Dryer, J. based his decision on a construction of the wording of the trust section of the Act. Whilst this construction of section 3 of the Act can he supported, the section is so badly drafted that a quite different construction could also he supported. The section should be revised in such a way as to indicate clearly that contractors and subcontractors are trustees only of people they themselves employ, and of the Workmen's Compensation Board.

The Commission recommends:

Section 3(1) of the Act [the trust section] should be redrafted so as to reflect the decision of Dryer, J. in Crane Canada Ltd. *v.* McBeath Plumbing & Heating Ltd.[28] *and should accordingly provide that a contractor or a subcontractor who holds moneys in trust under the section is a trustee only for persons he employs in connection with the improvement, and for the Workmen's Compensation Board.*

The second matter referred to above, that of priorities as between trust beneficiaries, was mentioned in the Commission's working paper. It was tentatively recommended that the priorities should be the same as these contained in section 40 of the Act in relation to liens. This question takes on something of a different aspect however in the light of the privity of trust doctrine. The situation in which all the parties who were involved in the construction project claim against the contractor as trustee cannot arise, aid so there is no need to determine what should be the priorities in such a situation. The contractor and subcontractor are both beneficiaries under the trust provision, but the clear intent of section 3 seems to be that all other trust beneficiaries enjoy priority over the contractor; and the effect of giving persons who claim under the subcontractor a right to treat the subcontractor as trustee is likely to ensure these claimants priority over the subcontractor. The major priority difficulties seem therefore to have a straightforward answer once the privity of trust notion is accepted. We have accordingly refrained from making any recommendation in connection with priorities as between beneficiaries under the trust.

(f) *Should the owner be a trustee of moneys before payment to the contractor?*

The Amalgamated Construction Association of British Columbia submitted to the Commission that the attachment of the trust should be extended to moneys in the hands of the owner. The Commission also received similar suggestions from lawyers. The Commission feels, however, that this is unnecessary if the other recommendations contained herein in connection with the trust are accepted. They will ensure that assignments by the contractor do not allow the

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27. (1963), 42 W.W.R. 1

28. (1965), 54 W.W.R. 119 (B.C.S.C.)

moneys to escape from the construction chain and that the contractor's creditor cannot obtain the funds free of the trust by garnishing the moneys.

There are no doubt other protections in addition to these that could be obtained by making the owner a trustee, but the Commission feels that the administrative difficulties likely to be involved in determining the rights of the various parties if the owner were made a trustee outweigh the additional possible advantage of making him a trustee. In the case where the owner is being financed entirely by a mortgagee, these difficulties would not be great. In the case where the owner was financing himself, it would be extremely difficult to know at what point the trust attached to what moneys. The Commission therefore makes no recommendation in connection with the owner being treated as a trustee.

SUMMARY OF RECOMMENDATIONS

The recommendations of the Commission are set out below.

1. The definition of a subcontractor should be amended to ensure that a person normally in the position of a subcontractor be treated as such for the purposes of determining priority amongst competing lien claimants.

2. The definition of a subcontractor be altered so as to make clear that materialmen are excluded from the definition.

3. The definition of a subcontractor be extended to cover persons who hire out equipment for use in connection with an improvement on land.

4. The following is a suggested draft of the definition of a subcontractor:

   "Subcontractor" means a person, other than a workman, who

   (a) contracts with or is employed by the contractor or under him by another subcontractor or an agent of a contractor or subcontractor to do work upon an improvement or both to do work upon an improvement and to place or furnish material for the making of an improvement; or

   (b) rents equipment, with or without an operator, for use in the making of an improvement;

   and a person may be a subcontractor within the meaning of this definition even though he contracts directly with the owner, if the work normally undertaken by a contractor is being undertaken by the owner, and in such a case the person shall not be treated as a contractor.

5. Architects and engineers should be included within the range of persons able to claim a lien and the definition of the services for which they are entitled to claim should include all work done in connection with an improvement, whether or not the work was done prior to the commencement of construction.

6. A provision similar in terms to section 10 of *The Mechanics' Lien Act 1968-69*, S.O.C. 65, be added to the *British Columbia Act*. It provides:

   > Save as herein otherwise provided, where the lien is claimed by any person other than the contractor, the amount that may be claimed in respect thereof is limited to the amount owing to the contractor or subcontractor or other person for whom the work has been done or the materials were placed or furnished.

7. The amount necessary to discharge all liens arising under a person from whom a holdback was retained should not exceed the amount of the holdback, provided it is equal at least to 15 per cent of the value of the work done and materials supplied in connection with the contract between the person who retained a holdback and the person engaged by that person.

8. Section 21(6) be amended so as to apply only to the 15 per cent holdback and not to additional sums that are in fact retained.

9. Section 21(1) should be amended so as to provide that where there is evidence to suggest that the contract price is abnormally low having regard to the amount of work agreed to be done, and it appears that the owner and contractor did not deal at arm's length, the holdback shall be calculated on the basis of the actual value of the work done; and evidence of the actual value of the work done may be adduced for this purpose.

10. Where no appropriation of moneys paid by the payor to the payee in connection with an improvement is made (whether it be contractor to subcontractor and materialman, or subcontractor to sub-subcontractor and materialman, or sub-subcontractor to materialman), the moneys paid shall be deemed to be appropriated to the debt due to the payee in connection with the improvement in respect of which the moneys became available; and in any proceedings brought under the Act, any party should be entitled to adduce evidence to the effect that a particular payment received by a lien claimant was in fact a payment of money in connection with the improvement in respect of which the lien claimant claims a lien.

11. A lien registered within the time limited for the registration of liens shall be enforceable against a purchaser of the land subject to the lien, even though it was not registered at the time the purchaser obtained title to the land; and the Act and the *Land Registry Act*, R.S.B.C. 1960, c. 208, s. 38(l)(g) should be amended to make absolutely clear that this is so. The reference in section 38(1) to mechanics' liens should be taken out of clause (g) and a new clause added to section 38(1) which provides that any mechanics' liens registered within the time for the registration of liens under the *Mechanics' Lien Act* shall be valid against the registered owner of the land, whether or not he was the registered owner at the time the right to a lien arose.

12. (1) The incorporation into the law of this Province of a provision similar to section 16 of *The Builders' Lien Act*, R.S.A. 1970, C. 35, with the amendment that the operative period for the filing of liens should be ninety-three days and for the release of holdbacks it should be one hundred days.

(2) The Act should provide that, notwithstanding recommendation (i), the latest time at which liens may be filed should be thirty-one days after completion or abandonment of the improvement.

13. The following is a suggested draft of the present sections 21 and 23 of the Act:

> 21. (1) Notwithstanding section 6, the owner, contractor, subcontractor or other person primarily liable upon any contract under or by virtue of which a lien may arise shall retain a holdback for a period of time known as the holdback period.
>
> (2) The holdback shall be retained for the holdback period irrespective of whether any contract to which subsection (1) applies provides for partial payments or payment on completion of the work;

(3) The holdback is an amount equal to fifteen per cent of the value of the work, service and materials actually done, placed or furnished, as described in section 5, in performance of a contract under or by virtue of which a lien may arise;

(4) The value of the work, service and materials referred to in subsection (3) shall be calculated upon evidence given in that regard on the basis of the contract price; but where there is no specific contract price, or where there is evidence to suggest that the contract price is abnormally low having regard to the amount of work agreed to be done and it appears that the owner and the contractor did not deal at arm's length, the holdback shall be calculated on the basis of the actual value of the work, service and materials and evidence of the actual value may be adduced for this purpose;

(5) A lien is a charge upon a holdback required to be retained by subsection (1) such that each holdback is charged with payment of all persons employed by or under the person from whom the holdback was retained;

(6) All payments up to eighty-five per cent of the value of work, services and materials calculated in accordance with subsections (3) and (4) made in good faith by a person required to retain a holdback to a person entitled to file a claim of lien shall discharge *pro tanto* any such lien;

(7) Payment of a holdback required to be retained by subsection (1), (including the holdback retained by an owner from a contractor or, if there is no contractor, from a subcontractor, in respect of a subcontract falling within section 21Y(2)) may be made after expiry of the holdback period and all liens and charges of the person to whom the holdback is paid, or of any person employed by or under the person to whom the holdback is paid, are thereby discharged unless in the meantime a claim of lien has been filed or proceedings have been commenced to enforce any claim of lien or charge against the said holdback.

21X. (1) In this section and in sections 21Y and 23 "supervisor" means an architect, engineer or other person upon whose certificate payments are to be made under a contract or subcontract;

(2) A subcontractor may at any time after the completion of his subcontract demand a certificate of completion of the subcontract from the supervisor, which demand shall be made in writing and may be delivered to the supervisor or sent to him by registered mail with postage fully prepaid and a copy of the demand shall be given to the owner or his agent, or sent to the owner or his agent by registered mail with postage fully prepaid;

(3) The supervisor to whom the demand is addressed shall within ten days of the making of the demand, and if he is satisfied that the subcontract is completed, issue and deliver to the

subcontractor a certificate of completion of the subcontract;

(4) If the supervisor neglects or refuses to issue or deliver the certificate of completion within ten days or if there is no supervisor, the court may, upon application of the subcontractor and upon being satisfied that the subcontract has been completed, make an order that the subcontract has been completed upon such terms and conditions as to costs or otherwise as seem just, and the order has the same force and effect as a certificate of completion issued by a supervisor would have.

21Y. (1) Where no certificate of completion has been issued by a supervisor, and where no order of the court has been made, to the effect that a subcontract has been completed,

(a) if the owner engaged a contractor, the holdback period is the forty days next after the contract between the contractor and the owner has been completed, abandoned or otherwise determined;

(b) if the owner did not engage a contractor, the holdback period is the forty days next after the improvement has been completed or abandoned.

(2) Where a certificate of completion has been issued by a supervisor, or where an order of the court has been made, to the effect that a subcontract has been completed, the holdback period in relation to that subcontract and all work, service or materials actually done, placed or furnished in connection with it, is the one hundred days next after the issue of such certificate or order, unless the forty day period referred to in subsection (1) expires before the one hundred day period referred to in this subsection, in which case the forty day period referred to in subsection (1) is the holdback period notwithstanding the issue of a certificate or order of the court that the subcontract has been completed.

23. (1) Where no certificate of completion has been issued by a supervisor, and where no order of the court has been made, to the effect that a subcontract has been completed,

(a) if the owner engaged a contractor,

(i) a claim of lien of a contractor or subcontractor may be filed in the manner provided in this Act at any time after the contract or subcontract has been made, but not later than thirty-one days after the contract of the contractor has been completed, abandoned or otherwise determined;.

(ii) a claim of lien for materials supplied may he filed in the manner provided in this Act at any time after the contract to supply the materials has been made, but not later than thirty-one days after the contract of the contractor has been completed, abandoned or

otherwise determined;

(b) if the owner did not engage a contractor,

(i) a claim of lien of a subcontractor may be filed in the manner provided in this Act at any time after the subcontract has been made but not later than thirty-one days after the improvement has been completed or abandoned;

(ii) a claim of lien for materials supplied may be filed in the manner provided in this Act at any time after the contract to supply the materials has been made, but not later than thirty-one days after the improvement has been completed or abandoned.

(2) Where a certificate of completion has been issued by a supervisor, or where an order of the court has been made, to the effect that a subcontract has been completed,

(a) a claim of lien of the subcontractor may be filed in the manner provided in this Act at any time after the subcontract has been made, but not later than ninety-three days after the issue of the certificate or order of the court;

(b) a claim of lien for materials supplied in connection with the subcontract may be filed in the manner provided in this Act at any time after the contract to supply the materials has been made, but not later than ninety-three days after the issue of the certificate or order of the court;

unless the thirty-one day period referred to in subsection (1) expires before the ninety-three day period referred to in this subsection, in which case the thirty-one day period shall replace the ninety-three day period notwithstanding the issue of a certificate or order of the court that the subcontract has been completed.

The present section 21(3) should be redrafted as follows:

A claim of lien of a workman may be filed in the manner provided in this Act at any time during the performance of the work, but not later than thirty-one days after the last work has been done by him for which the lien is claimed, except for a lien claimed in respect of a mine or quarry, when the time herein before mentioned shall be sixty days; but no workman shall be held to have ceased work on an improvement until the completion of the same if he has in the meantime been employed upon any other work by the same contractor or sub-contractor.

The present section 21(4) should be redrafted as follows:

Every lien or charge in respect of which a claim of lien is not filed in the manner and within the time provided in this Act

is extinguished.
Definitions:

1. Abandonment means the expiry of a period of thirty days during which no work has been done in connection with the contract or improvement, as the case may be, unless the cause for the cessation of work was and continued to be a strike, lockout, sickness, weather conditions, holidays, order of a court, a shortage of materials, or other such like cause; and abandoned has a corresponding meaning.

2. A certificate of completion of a subcontract issued by a supervisor is deemed to be issued on the date on which it is issued, providing the subcontractor and the owner both receive copies of the certificate within ten days of the date of issue; but if either the subcontractor or the owner does not receive a copy within the ten day period, the certificate is deemed to be issued on the later of the dates on which the subcontractor and the owner receive a copy of the certificate.

The present section 21(5) should be redrafted as follows:

The provisions of this Act relating to holdbacks apply to every contract in respect of which a lien is capable of arising under this Act notwithstanding any term to the contrary contained in such contract.

14. The Act should be amended so as to provide that in the case of the supply of materials in respect of a mine or quarry, a claim of lien may be filed not later than 60 days after the last materials have been supplied by the lien claimant to the mine or quarry, regardless of whether all, part or none of the materials were supplied pursuant to a prevenient agreement.

15. The holdback provisions of the Act should be amended so as to provide that a holdback in respect of the supply of materials, or in respect of work done by a workman, in connection with a mine or quarry shall be retained for a period of seventy days after the last materials have been supplied, placed or furnished to the mine or quarry or the last work done on the mine or quarry.

16. The definition of "completed" in section 2 of the Act be amended so as to make clear that it includes improvements as well as contracts in respect of improvements.

17. The adoption of the following definition of substantial performance:

For the purposes of this Act, a contract shall be deemed to be substantially performed or an improvement substantially complete.

(a) when the work or a substantial part thereof is ready for use or is being used for the purpose intended, and

(b) when the work to be done under the contract is capable of completion or correction at a cost of not more than

(i) three per cent of the first $250,000 of the contract price,

(ii) two per cent of the next $250,000 of the contract price, and

(iii) one per cent of the balance of the contract price.

For the purposes of this Act, where the work or a substantial part thereof is ready for use or is being used for the purpose intended and where the work cannot be completed expeditiously for reasons beyond the control of the contractor, the value of the work to be completed shall be deducted from the contract price in determining substantial performance.

18. (1) For the removal of doubt, the Act should make clear that the giving of security to procure the cancellation of a lien does not deprive the owner of the protection given to him by section 6.

(2) The contractor or any person liable on any contract in connection with the improvement be allowed to provide security.

19. (1) The addition of a new section to the Act in the following terms:

(1) Where a claim of lien has been filed in accordance with section 24 of this Act, the owner, the contractor, a subcontractor or a mortgagee authorized by the owner to disburse the moneys secured by a mortgage may,

(a) by interlocutory application in any proceedings that have been commenced to enforce a lien, or

(b) on application by originating notice of motion;

pay into court the aggregate amount which may be recovered by all lien claimants.

(2) Payment into court ordered under subsection (1) discharges the owner from any liability in respect of liens and

(a) the money paid into court stands in the place of the land, and

(b) the order shall provide that the liens be removed from the title to the land concerned.

(3) Where an application has been made in accordance with subsection (1) and the liens have been removed in accordance with subsection (2), if additional liens are then filed, application may be made in accordance with the procedure laid down in subsection (1) to have the additional liens removed in accordance with the provisions of subsection (2)on payment into court of whatever additional sum, if any, is necessary to bring the amount in court up to the aggregate amount recoverable by all lien claimants.

(4) On application under subsection (1) or (3), the court may

(a) hear and receive such evidence, by affidavit or viva voce or otherwise, as it considers necessary in order to determine the proper amount to be paid into court,

(b) direct the trial of an issue to determine the amount to be paid into court, and

(c) refuse the application if it is of the opinion that the determination of the aggregate amount which may be recovered by lien claimants should be made at the trial of the action.

(2) Section 30(1) of the Act should be amended so as to provide:

> ... a claim of lien or liens for any amount may be enforced by action in the Court or an application made according to the practice and procedure of the Court ...

20. (1) The plaintiff in a mechanics' lien action may commence suit in the Supreme Court of British Columbia if the amount in issue exceeds $3,000 and if the plaintiff elects to begin such an action in the County Court, the defendant should be given the right to have the matter transferred to the Supreme Court of British Columbia.

    (2) For the purpose of recommendation (i), the "amount in issue" should mean the total amount in issue in a consolidated lien action, so that where there are several lien claimants, none of whom individually claim $3,000, but who collectively claim an amount in excess of $3,000, the action should be triable in the Supreme Court of British Columbia.

21. With the consent of all parties, a mechanics' lien action may be brought in any County Court. But in the absence of such consent, the action should be started in the county in which the land alleged to be subject to a lien is situated and any part should then be able to request a change of venue.

22. Section 26(2) should be amended so as to allow the owner or his agent to send to the lien claimant a notice to commence an action, and Form II of the Schedule to the Act should be amended accordingly.

23. Where a lien has been cancelled as a result of security having been given in accordance with section 33 or where a lien has been removed as a result of payment into court of the aggregate amount recoverable by lien claimants, it should not be necessary for the lien claimant or the lien claimants to register a certificate of *lis pendens*.

24. It should be no longer necessary to file an affidavit of claim of lien under the Act in the County Court Registry and that sections 24 and 25 of the Act should be amended accordingly.

25. The addition to the Act of a section providing that if the person to whom materials were supplied, or his agent, signs an acknowledgment of receipt of the materials stating that they are received for inclusion in an improvement at a named address, the materials will *prima facie* be deemed to have been delivered to the land described by the address.

26. Where the amount in issue in a mechanics' lien action exceeds $3,000, costs, whether of the plaintiff or the defendant, should be taxed according to the Supreme Court tariff.

27. (1) Where a contractor or a subcontractor obtains a labour and material payment bond in holdback form, the person employing the contractor or subcontractor, as the case may be, should he under no statutory obligation to retain a holdback in respect of work done or materials supplied the payment for which is provided for in the bond; and only moneys in fact retained will he subject to a lien or charge and such lien or charge will be postponed to the right of the person retaining such moneys to set off against them any amount additional to the original contract in respect of which the moneys were retained.

(2) In these recommendations:

(a) A labour and material payment bond in holdback form is an instrument or obligation binding on a surety whereby

(i) on the failure of the principal to discharge a debt to a claimant, the surety is liable, up to an amount of not less than 50 per cent of the contract price of the contract between the principal and the obligee, to discharge that debt, and

(ii) on the failure of the principal to cancel or discharge, within seven days from the date of filing, a lien filed in the manner provided in the Act, the surety is liable, up to an amount of not less than 50 per cent of the contract price of the contract between the principal and the obligee, to cancel or discharge that lien within fourteen days from the date on which it was filed,

provided that the total liability of the surety under a labour and material payment bond in holdback form need not exceed 50 per cent of the contract price of the contract between the principal and the obligee.

(b) "Principal" refers to a contractor or subcontractor who obtains a labour and material payment bond in holdback form;

(c) "surety" refers to the person liable on the default of the principal under a labour and material payment bond in holdback form;

(d) "claimant" refers to a person who contracts with a principal for the doing of work or for the supply of materials;

"obliges" refers to a person who engages a principal in connection with an improvement.

(3) Where the cost to the principal of discharging a lien would be less than the cost to some other party, the liability of the surety under the labour and material payment bond in holdback form need only extend to the lesser cost in order for recommendation (2)(a)(ii) to be satisfied.

(4) Subject to recommendation (v), where, as a result of a variation in the contract between the principal and a claimant, the liability of the surety to the claimant would be discharged under the general law relating to suretyship, the surety should continue liable unless

(a) before the claimant agreed to the variation he had been given notice by the surety that any proposed variation in the contract between the claimant and the principal should be communicated to the surety, and

(b) either the claimant failed to communicate the proposed variation to the surety or the surety informed the claimant, within ten days of receiving notice of the proposed variation,

that the surety refused to guarantee payment by the principal in relation to the proposed variation.

(5) Subject to recommendation (vii), where, as a result of a variation in the contract between the principal and a claimant, the liability of the surety to the claimant would be discharged under the general law relating to suretyship and the variation is made consequent upon, or in accordance with, a variation in the contract between the obligee and the principal which would under the general law of suretyship discharge the surety from liability in respect of a guarantee of the principal's obligations to the obligee, and the surety has not consented to either variation, the surety should be discharged from liability to the claimant under a labour and material payment bond in holdback form, but unless these conditions are satisfied the surety should continue to be liable to the claimant under the bond.

(6) Every instrument intended to be or represented to be or purporting to be a labour and material payment bond in holdback form should contain the following statement:

"IMPORTANT WARNING: LIABILITY
UNDER THE MECHANICS' LIEN ACT

"Every intended modification or variation in the contract between the principal and the obligee must be communicated to the surety before any work is done or any preparations made in respect of the modification. Any intended extension in the time for completion or in the place of performance should also be communicated before it is agreed to. Failure to comply with this warning may result in the surety's discharge from obligation under this bond and any performance bond that has been issued and will also result in substantial liability on the part of the owner-obligee under the *Mechanics' Lien Act*."

The statement should appear in the upper half of the page of such an instrument, either at the top of the page, or under the surety's name or under the description of the instrument and the statement should be contained in a box, the outline of which is red in colour.

(7) Failure to comply with the previous recommendation should disentitle the surety from raising in any court of law the defence that he is discharged from liability under a labour and material payment bond in holdback form by reason of a variation in the obligation guaranteed.

(8) When an instrument intended to be or represented to be or purporting to be a labour and material payment bond in holdback form is unenforceable or fails to satisfy the requirements of recommendation (2)(a)

(a) owing to the provisions of recommendation (v), the obliges shall be subject to the same liability as if he had not been excused by recommendation (i) from the obligation to retain a statutory holdback, or

(b) for any reason other than the provisions of recommendation

(v), the obliges shall be excused from the obligation to retain a statutory holdback and the provisions of recommendation (i) shall apply, providing that the obligee had a reasonable and honest belief that the principal had obtained a labour and material payment bond in holdback form in accordance with the terms of recommendation (ii)(a).

(9) Section 2(39) of the *Laws Declaratory Act*, R.S.B.C. 1960, c. 213, dealing with the liability of a surety to claimants, should be contained in the *Mechanics' Lien Act*.

(10) Machinery should be established for determining what persons or corporations are entitled to issue labour and material payment bonds in holdback form so as to relieve the obliges from the duty to retain a holdback.

28. Retention of the trust provision, but with certain changes in its operation.

29. The right to assert the existence of a trust should continue to be unaffected by the fact that the time limited for filing a lien has expired.

30. Section 4 be amended so as to make it clear that the operation of the trust is not excluded.

31. Where moneys owing to a contractor or subcontractor would, if paid to the contractor or subcontractor, be subject to a trust under section 3(1) of the Act, such moneys shall not be subject to attachment under the *Attachments of Debts Act*, R.S.B.C. 1960, c. 20.

32. No change be made in the Act with regard to priorities as between the trustee in bankruptcy of a trustee under section 3 and a beneficiary of the trust on the basis that the present law provides that the trustee in bankruptcy who receives moneys, which are earned in respect of an improvement, from the owner, receives them subject to the trust.

33. A provision similar to the present section 19(1) be retained, according to which "no assignment by the contractor or subcontractor of any moneys due in respect of the contract is valid against any ... trust created by this Act."

34. The Act should contain a provision similar to section 2(6) of *The Mechanics' Lien Act*, S.O. 1968-69, c. 65. It provides:

> Notwithstanding anything in this section [the trust section], where money is lent to a person upon whom a trust is imposed by this section and is used by him to pay in whole or in part for any work done, for any materials placed or furnished or for any rented equipment, trust moneys may be applied to discharge the loan to the extent that the lender's money was so used by the trustee, and any sum so applied shall be deemed not to be an appropriation or conversion to the trustee's own use or to any use not authorized by the trust.

35. There should be a limitation period of one year in respect of all claims by a beneficiary under the trust, and the period should run from the time of completion, abandonment, or other discharge of the contract, or of the

completion or abandonment of the improvement, in respect of which the claim arose.

36. Section 3(1) of the Act [the trust section] should he redrafted so as to reflect the decision of Dryer, J. in *Crane Canada Ltd.* v. *McBeath Plumbing & Heating Ltd.* and should accordingly provide that a contractor or a subcontractor who holds moneys in trust under the section is a trustee only for persons he employs in connection with the improvement, and for the Workmen's Compensation Board.

CONCLUSION

The recommendations we have made in this Report will, if implemented, have a far-reaching effect on the operation of the law relating to mechanics' liens. Most of the more important recommendations we make are concerned with the central problem of reconciling the need to provide a reasonable degree of protection to lien claimants with the need to encourage the flow of funds along the construction chain. Our recommendations that there be a separate holdback system, an alternative to the holdback system and a provision for the early release of holdbacks, would, we believe, effect this reconciliation in a more realistic fashion than does the present law.

In compiling this Report, we have benefited from the assistance and kindly criticism of many members of the legal profession and the construction industry, both from within and from outside the Province. To all of those who helped us, we wish to express our warmest thanks.

E. D. FULTON
Chairman

R. GOSSE
Commissioner

R. C. BRAY
Commissioner

June 30, 1972.

APPENDIX A

The Machinery of the Holdback System

In order for the recommendation to be implemented, the Commission believes that certain additional machinery will be required over and above the recommendation based on section 10 of the *Ontario Act* that there be a separate holdback system.

Because of the complexity of the situations in question and of the provisions necessary to deal with them, and because of the infrequency with which these situations are likely to occur, we have relegated what we have to say about them to this appendix. The material that follows is intended to outline the situations of difficulty and to embody suggestions for their solution.

We do not pretend that our suggestions are simple, or that they make easy reading, and we are aware that anyone reading them for the first time is likely to conclude that we are seeking to introduce greater complexity into an area of law that is already difficult enough. We believe however that their effect will be to make the Act easier to comply with for members of the construction industry. Our suggestions, based on the separate holdback principle, are designed to promote the flow of funds along the construction chain by ensuring that as long as a party holds back 15 per cent of the value of the work done under the contracts with the people he employs, he has protected himself completely against exposure to risk if liens are filed. This, we hope, will make the Act fairer and more practicable for the construction industry. Most of the detailed suggestions contained in this appendix concern what is to happen to those various 15 per cents that are retained. At this stage, of course, liens have already been filed and the question is how much can a lien holder recover, from whom can he recover it and with whom must he share it. It is highly probable that the parties will at this stage be represented by their solicitors and it is therefore the latter who will have to work with the new provisions if they are adopted.

This is no reason why the law should be made any more complex than is necessary. In this instance, however, we believe that simplicity is illusory. The present wording of the Act is an adequate demonstration of this. Individual sections and provisions of it appear simple enough, but they frequently do not stand up to close investigation. In some cases this is due to obscure wording or ambiguity. But one element is often that provisions are over-simplified in conception and are just not adequate to meet the complicated circumstances that may arise. We have sought, in making our main recommendations in connection with holdbacks, viz. that each holdback should be separate, to think through as many of the more difficult situations as we could discover in order to test the working of our recommendations. Some of them are not likely to arise very often. But the Commission felt that if a major new system for the operation of the holdback was to be recommended, this was the proper way to do it.

The root cause of much of the difficulty lies in the two-fold definition given to the lien under the Act. It is defined as a lien upon the owner's land and the improvement (section 3) and as a charge upon holdbacks "in favour of claimants whose liens are derived under persons to whom the moneys ... required to be retained are respectively payable ..." (section 21(2)). This latter definition suggests that the holdback system was originally intended to operate progressively, as we are

recommending in this Report that it should. But, perhaps because of the decision in the *Denston*[1] case that every lien claimant can claim against the owner's holdback, lien claimants do not in fact exercise against persons other than the owner the rights by way of charge that are expressly given to them under section 21(2); and there is no reason why they should, if they can claim against the owner's holdback.[2]

As long as lien claimants are permitted to proceed directly against the owner, the separate holdback scheme can, in some circumstances, be frustrated by the mechanics of enforcing the lien. In the simple situation of a single lien claimant where the only insolvent person is the one who employed the lien claimant, the problem does not arise. If, for example, a supplier of a sub-subcontractor files a lien, the owner will instruct the contractor to clear the lien. The contractor will then require his subcontractor under whom the lien arose to clear the lien. If the subcontractor is solvent, he will remove the lien by payment, settlement or payment into court. If the lien is removed in this way, there is no difficulty and the separate holdback scheme has worked effectively. The subcontractor will be able to reimburse himself for discharging the lien out of the holdback he has retained.

The situations in which difficulties arise are intricate and are best understood with the aid of a diagram. Suppose that neither SSA nor MB2 has been paid for the work he has done and each files a lien. For the sake of simplicity, we may assume that all the work has been completed and neither lien claimant has been paid anything.[3] SSA therefore claims $30,000 and MB2 claims $10,000. Under the proposed scheme, SSA will be entitled *prima facie* to recover 15 per cent of the subcontract price of the subcontract between C and S ($10,500), which sum the contractor should have retained. MB2 will be entitled *prima facie* to recover 15 per cent of the sub-subcontract price between S and SSB ($3,000). If both C and S have retained these sums, there is no difficulty. But if S is insolvent (as suggested by the fact that SSA is unpaid) and cannot discharge MB2's lien, the burden falls on C, in accordance with his contractual obligations to the owner. This raises several difficulties.

1. A Problem of Measuring the Claim

Firstly, how does this additional duty imposed on C affect his liability under the separate holdback scheme? Assuming C to have retained 15 per cent from S in accordance with the scheme, all of this sum is notionally earmarked for payment of lien claimants in the position of SSA. SSA is unpaid in the sum of $30,000. The most he can recover is $10,500 (the holdback in C's hands). If C pays the whole $10,500 to SSA, he has nothing left in the form of a holdback to discharge MB2's lien. Yet C remains contractually liable to 0 to discharge MB2's lien. It will be seen from this that even with the adoption of the recommendation based on section 10 of the *Ontario Act*,[4] viz. limiting the sum which a single lien claimant may recover to the amount owing to the person who employed the lien claimant, the measure of the contractor's risk would not in all cases be limited to the amount he has retained by

1. (1958), 27 W.W.R. 141; 13 D.L.R. (2d) 494, (B.C.C.A.).

2. Unless they could recover both the owner's holdback and the sum owing to the person who employed them, a view which as far as the Commission is aware has never been advanced.

3. This is an unrealistic assumption for such a situation is unlikely to arise. No point of principle relevant to the distribution of holdback moneys is raised by making such an assumption, however, and the example is more manageable when cast in such terms.

4. *Supra*, at p. 67.

way of holdback. It would still be possible for several lien claimants, claiming under different subcontractual chains, to claim from the owner (up to a limit of the owner's 15 per cent holdback) sums which in combination would expose the contractor to a liability greater than that which the holdback he has retained is adequate to discharge. The above example is such a case.

The Commission believes that it is important to maintain the principle that the contractor should not be subject to a greater risk than is implied by his retaining a holdback of 15 per cent from each of his several subcontractors. Situations do arise in which there are failures under more than one sub-subcontractual chain. In such circumstances, the choice is between imposing the additional burden on the contractor, or distributing an additional portion of the loss between the various lien claimants. As has already been stated, the Commission has been strongly influenced by the logic of the views of members of the construction industry who have emphasized the need to amend the Act so as to improve the flow of funds along the construction chain. In response to this consideration, we have concluded that it is essential for the contractor and subcontractor to be able to forecast the measure of their exposure to risk and to be able to take steps to provide for it.

This policy would be thwarted if situations could arise in which, although a single lien claimant could not claim more than the sum owing to the person who employed him, the coincidence of a number of lien claims could expose the contractor or a subcontractor to a greater risk than that against which their 15 per cent holdback is sufficient to protect them. We believe therefore that the amount retained by the contractor from a particular subcontractor should, provided it is at least 15 per cent of the value of the work done under the subcontract, be the maximum which all lien claimants who claim under that subcontractor may recover. The same should apply, *mutatis mutandis* to the amount retained by a subcontractor. The recommendation embodies this principle, and the material which follows is designed to indicate how it might be implemented.

The Commission suggests:

In any action to enforce a claim of lien

(i) the aggregate amount which may be recovered by all lien holders who claim under the same subcontractor should not exceed the sum retained by the contractor from the subcontractor under whom the lien holders were employed, provided that this sum is equal to 15 per cent of the value of the work done under the relevant subcontract;

(ii) the aggregate amount which may be recovered by all lien holders who claim under the same *sub-subcontractor* should not exceed the sum retained by the subcontractor from the sub-subcontractor under whom the lien holders were employed, provided that this sum is equal to 15 per cent of the value of the work done under the relevant sub-subcontract;

(iii) where the sum retained by the contractor or subcontractor is less than the 15 per cent referred to in provisions (i) and (ii), the lien holders who claim under the same subcontractor or sub-subcontractor, as the case may be, may recover an aggregate amount equal to that 15 per cent;

(iv) in the above three provisions, subcontractor means a person, other than a materialman, who contracts with a contractor in connection

with an improvement; sub-subcontractor means a person, other than a materialman, who contracts with a subcontractor as defined in this provision; and subcontract and sub-subcontract have corresponding meanings.

2. A Problem of Distributing the Available Lien Funds

A second difficulty raised by a slight variation in the example given above of two competing lien claimants claiming under the same subcontractor, but under different sub-subcontracts, arises out of the point just discussed. What is to be the distribution of the available lien funds amongst the competing lien claimants? The relevant provision of the Act is section 40. It provides that:

> "Subject to section 7, all moneys realized by action or proceedings under this Act or paid into Court under section 21 shall be applied and distributed in the following order:
>
> (a) The costs of all the lien-holders of and incidental to the proceedings of registering and proving their claims of lien:
>
> (b) Six weeks' wages (if so much is owing) of all workmen employed by the owher, contractor, and sub-contractor:
>
> (c) The sums of money owing the workmen in excess of six weeks' wages, the materialmen, and the sub-contractors:
>
> (d) The amount owing the contractor.
>
> Each class of lien-holders shall rank *pari passu* for their several amounts, and the portions of the said moneys available for distribution shall be distributed among the lien-holders *pro rata* according to their several classes and rights. Any balance of the moneys remaining after all the above amounts have been distributed is payable to the owner of other person legally entitled thereto.

This is a difficult section and there appears to be no clear authority as to its meaning. For one thing it is not clear what constitutes a "class" of lien holders for the purpose of the *pari passu* ranking. Presumably the groups referred to in clauses (a), (b), (c) and (d) cannot constitute the classes, since to allow those groups to rank *pari passu* one with another would destroy the effect of the opening words of the section which indicate a clear intention to establish an order of priority. There seem to be two ways of construing the *pari passu* tanking of classes, neither of them entirely free from difficulty. Firstly, the clause "each class of lien-holders shall rank pari passu" might be taken to mean "The members of each class of lien-holders shall rank pari passu." On this view the expression "class" is referable to the groups referred to in clauses (a), (b), (c) and (d), but it is not the classes that rank *pari passu*, but the members *inter se* of a given class.

Secondly, the meaning of "class" could be entirely dissociated from clauses (a), (b), (c) and (d) and defined in some other way. The Act is of no help in indicating how, in that case, a class should be defined. The most likely view would seem to be that a class consists of all people who contract directly with the same person. This view receives some slight support from the Ontario case of *McPherson* v. *Gedge*[5] in

5. (1883-4), 4 O.R. 246 (Ont. C.A.).

which one member[6] of the Ontario Court of Appeal (Osler, J.A.) said: "The plaintiffs and the applicant are lien holders of the same class: that is to say, they all contracted directly with or were employed by the same person, for that is what is meant by this expression ..."[7] Neither Galt, J.A. (who dissented from the majority), nor Wilson, C.J., expressly dealt with the point. Further, the meaning of "class" was in issue for the purpose of determining whether the applicant could take advantage of the provision at that time contained in the *Ontario Act* that "... all suits brought by a lien-holder shall be taken to be brought on behalf of all the lien-holders of the same class." It is also true however that the *Ontario Act* at that time contained a provision in the same terms as the one now under discussion in the *British Columbia Act* so that it could be argued that the word "class" should have carried the same meaning in both contexts in which it appeared in the *Ontario Act*. This is hardly conclusive authority, amounting, as it does, to a statement by a single judge in a three man court in a very old Ontario case concerned with a different point.

Under the present law of British Columbia, nothing turns on which approach is taken since there is nothing to limit the amount which a single lien claimant may claim other than the amount of the owner's holdback. It does not matter, therefore, whether two sub-subcontractors claiming under the same subcontractor are treated as one class with a priority computation base[8] consisting of the aggregate of their two lien claims, or whether they are each treated as separate and individual members of a class which includes all other sub-subcontractors and all subcontractors and materialmen.

If the Commission's recommendations, that there be separate holdbacks and that the holdback retained by the contractor (and, *mutatis mutandis*, the subcontractor) from a particular subcontractor should be the maximum amount which all lien claimants who claim under that subcontractor may recover, are accepted, it will become important in some circumstances to determine the answer to the problem discussed above. Referring to the diagram, assuming that SSA, MB1 and MB2 have completed their work, been paid nothing and have filed valid liens, how should the available lien funds be distributed among them? If S and SSB are insolvent, the duty of discharging the liens falls upon C.

If the Commission's recommendations[9] in favour of a separate holdback system were adopted, the maximum amount recoverable by the lien claimants would be $10,500 assuming C to be indebted to S by the 15 per cent holdback and no more.

There are several different possible methods of distribution. Firstly, the claimants could share the fund of $10,500 in proportion to their respective claims (SSA - $30,000; MB1 - $5,000; MB2 - $10,000). Secondly, a priority computation base could be established at the level of the maximum amount recoverable by each

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6. At p. 26.

7. Emphasis in the original.

8. We have used this expression not out of a penchant for creating new jargon, but simply because it is difficult to find a suitable term to describe that part of a claim which is to be taken as the working figure for the purpose of determining how the claimant's share of a fund is to be rated against that of competing claimants to the same fund.

9. *Supra*, at pp. 67 and 69.

individual (SSA - $10,500;[10] MB1 - $3,000; MB2 - $3,000); and thirdly, a priority computation base could be allocated to a class of lien claimants by determining the amount which that class would recover if there were no other lien claimants. Thus, if MB1 and MB2 were the only lien claimants, the aggregate amount they could recover would be $3,000, this being the sum S should have retained from SSB. They should, on this view, therefore share a priority computation base of $3,000. In the result SSA as one class and MB1 and MB2 as another class should be entitled to the $10,500 fund divided between them according to their respective class priority computation bases (SSA - $10,500; MB1 and MB2 - $3,000) and MB1 and MB2 would then divide their portion, either rateably or equally.[11]

The Commission believes that the third of these three possible bases of distribltion is the best solution on principle and is more consistdnt with the separate holdback scheme which we are recommending. If the priority computation base is cast in terms of maximum amounts recoverable rather than the amounts of valid lien claims, the effect will be to give a preference to those who have extended a moderate amount of credit at the expense of those who have extended a large amount of credit. This is consistent with our general view of the Act. It is not designed to give a secondary set of remedies to people who supply unlimited credit; it is designed to provide security to the otherwise unsecured creditor for a grant of reasonable credit. We therefore prefer to see the priority computation base assessed by reference to maximum amounts recoverable rather than amounts of valid lien claims. That disposes of the first possible method of distribution of the available lien funds.

In choosing between the second and third bases, the Commission has been guided by the logic of the separate holdback scheme. We have stressed the importance of the principle that a lien claimant should be entitled to recover a maximum of the sum owing to the person who employed him (provided this amounts to 15 per cent of the value of the work done under the relevant contract). And, consistently with the principle of defining the exposure to risk of the contractor and subcontractor, we have suggested that the coincidence of two lien claimants should not operate so as to enlarge their exposure to risk. The aggregate amount MB1 and MB2 could recover is a sum equal to the holdback retained by S. It seems to us, therefore, that it would be illogical to allow MB1 and MB2 a priority computation base equal to the sum of the amounts which each would be entitled to claim if he were the only claimant (a total of $6,000) when the maximum aggregate amount they are entitled tb share between them is $3,000. In short, the aggregate amount which MB1 and MB2 are permitted to recover should be the measure of their priority base vis a vis other lien claimants of a different class.

It also follows from this principle that where the priority computation base amounts to more than the sum in respect of which a single lien claimant is able to prove a valid lien, or more than the aggregate sum in respect of which a class of lien claimants are able to prove valid liens, the priority computation base applicable to that lien claimant or that class of lien claimants should be reduced accordingly.

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10. To simplify the accounting process, figures have been used which assume that C retained only 15 per cent from S and S retained only 15 per cent from SSB.

11. It will be seen that other factual configurations can raise the same kind of problem. Thus, if MM and SSA are both unpaid and C and S are both insolvent, again there will be a problem of determining the priority occupation base for the purpose of distribution of lien funds. This situation does not create the problem of determining the priority computation base of a class comprising more than one lien claimant however.

From what has been said above, it will be seen that the Commission believes the problems created by the wording of section 40, and, in particular, the difficulty surrounding the meaning of the word "class" should be answered by providing that where two or more lien claimants fall within the same clause of section 40, the individual lien claimants should be ranked by class; a class should consist of all people employed by the same person; and the priority computation base of each class should be the amount owing to the person who employed the members of that class.

The only outstanding point to be considered in connection with distribution of the available lien funds is how members of the same class should rank *inter se*. The problem here is rather different from that which arises when the lien claimants in competition for the available holdback funds are on different levels of the construction chain. Referring to the diagram, the separate holdback scheme is designed to ensure that, *prima facie*, C's holdback is available to discharge liens registered by people in the position of SSA and SSB; and that S's holdback is available to discharge liens registered by people in the position of MA, MB1 and MB2.

Sometimes that *prima facie* position is disturbed, as when there are two bankruptcies in the same construction chain. In that case, where for example S and SSB are both bankrupt, the Commission has recommended that MB1 and MB2, should receive a share of the holdback C has retained, despite the fact that that holdback is *prima facie* designed to pay SSA and other lien claimants in the same position in the construction chain. We have tried to find a reasonable compromise here between, on the one hand, ensuring that lien claimants are not deprived of all protection because there is a string of bankruptcies and, on the other hand, retaining the main features of the separate holdback scheme, by providing that the priority computation base of lien holders from different classes shall be the aggregate amount recoverable by the class and not the amount for which the members of the class have liens.

In the case where competitors in the distribution of the availabld lien funds are all from the same class, the problem of holdbacks having to be shared with people other than those for whom they were *prima facie* intended does not arise, and the mode of distribution amongst members of a single class *inter se* has no repercussions on the operation of the separate holdback scheme. Consequently, we do not feel that amongst lien claimants of the same class, there is any need to replace the more usual *pari passu* ranking with the type of ranking recommended as between different classes of lien holders. Lien holders who are members of a single class should share the lien funds available to that class *pari passu*, that is, a lien holder should recover a proportion of the lien funds available to the class of which he is a member, and the proportion should be the proportion that the lien holder's lien bears to the aggregate amount of the liens of members of the class, including the amount of the lien of the member whose proportion is being assessed.

The Commission suggests:

(1) Subject to provisions (iii), (iv), (v) and (vi), the Act should provide that for the purpose of distributing the available holdback funds amongst more than one lien holder of the type referred to in section 40(c), a priority computation base should be attributed to each lien holder and the priority computation base should be equal in amount to the sum owing to the person who employed the lien holder whose priority computation base is being determined.

(2) The priority computation base is the figure to be used in determining the portion of the available holdback funds which each of the various lien holders of the type referred to in the previous provision is entitled to recover and, subject to provisions (iii), (iv), (v) and (vi), where there is more than one lien holder of the relevant type, a single lien holder should be entitled to that proportion of the said funds which the lien holder's priority computation base bears to the aggregate amount of the priority computation bases of all lien holders of the relevant type, including that of the lien holder whose portion is being assessed.

(3) Two or more lien holders employed by the same person should constitute a class of lien holders.

(4) The priority computation base of a class of lien holders should be equal in amount to the sum owing to the person who employed the members of the class.

(5) The portion of the available holdback funds recovered by a class of lien holders should be distributed *paripassu* among the members of the class; that is to say, a single member of the class should be entitled to that proportion of the sum recovered which the amount of the member's lien bears to the aggregate amount of the liens of all members of the class, including that of the member whose recovery is being assessed; provided that no member of the class shall recover more than the amount of his lien.

(6) Where the priority computation base applicable to a lien holder in accordance with provision (i) exceeds the amount of his lien, or where the priority computation base applicable to a class of lien holders in accordance with provision (iv) exceeds the aggregate amount of the liens of the members of the class, the priority computation base applicable to that lien holder or to that class of lien holders should be reduced in each case by the amount of the excess.

(7) The "available holdback funds" referred to in provisions (i), (ii) and (v) means the amount paid into court or adjudged due in respect of particular liens, a particular class of liens or particular classes of liens.

3. A Problem with Holdbacks that Exceed 15 Per Cent

Another problem, caused by the mechanism created by the Act for enforcing lien rights, occurs in certain situations when the amount retained by a party in the construction chain exceeds the minimum statutory holdback of 15 per cent. Like the point discussed above under "1. *A Problem of Measuring the Claim*,"[12] it arises out of the need to ensure that a party's 15 per cent statutory holdback marks the limit of his exposure to risk.

Referring again to the diagram, assume that MA has wholly discharged his contractual obligation, has been paid nothing and has filed a lien for $20,000. If S has retained a holdback of 15 per cent only ($4,500) from SSA, MA is entitled to recover $4,500 in his lien action. Suppose, however, that S has paid nothing to SSA and is indebted to him for the full contract price of $30,000. According to the recommendation the Commission has made based on section 10 of the *Ontario Act*,[13] the maximum amount available for discharging MA's lien is $30,000, this being the amount owing to the person (SSA) who employed the lien claimant.

It is clear that MA cannot and should not be able to recover more than $20,000, this being the amount of his lien claim. The figure of $30,000 marks the limit of the available lien funds, not the measure of MA's entitlement. When MA registers his lien against O's title, O will instruct C to remove the lien and C will instruct S to remove the lien, which S will normally do if he is solvent. In such a case, the separate holdback scheme has worked effectively and the holdback retained by S from SSA has been used to discharge the lien arising under SSA.

If, on the other hand, S is insolvent and cannot discharge the lien, that duty will devolve upon C, the contractor. The Commission believes that, in this situation, C should not be liable for more than the amount which he has held back, provided always that this is 15 per cent of the value of the work done under the contract with

12. *Supra*, at p. 241.

13. *Supra*, at p. 67.

S. To render the contractor liable for the full $20,000 (an amount owing by S to SSA) when the contractor has retained only his 15 per cent statutory holdback ($10,500) would be a departure from the policy which we have sought to incorporate into the holdback system, namely, that the holdback retained by a contractor (or a subcontractor) should mark the limit of his exposure to risk as a result of lien claims arising under the person the contractor (or subcontractor) employed.

The attempt to build in this limit to the contractor's exposure to risk poses a problem in terms of the Act's mechanism for enforcing lien rights. In the example given above where MA has a lien for $20,000 and S has paid nothing to SSA, that is to say, he has retained a holdback of $30,000 from SSA, MA should recover the full amount of $20,000 if S is solvent; but MA should be confined to the amount of C's holdback (as long as it is 15 per cent) if S is insolvent. It is difficult to reflect this result in the context of a lien action brought against the owner.

One difficulty would be to know how much should be paid into court in order to effect a summary discharge of the liens.[14] Another problem would arise at the trial when the amount MA should recover in the lien action had to be determined. If that amount depended on S's solvency, the effect would be to compel C to sue S before the amount MA could recover could be determined. It is not simply that C would have a right of indemnity against S if S failed to discharge the lien and C were compelled to do so; rather, O's duty, and hence C's contractual obligation should themselves be limited, to the extent that S is unable to disgorge the de facto amount of his holdback. A more right of indemnity would not preserve to C the protection of his holdback, since S might be insolvent. Consequently the only way, consistently with the policy of preserving C's holdback protection, of determining the sum recoverable by MA would be to have an adjudication as to S'd solvency before determination of the amount to be paid to MA in satisfaction of his claim of lien.

Such a provision would be impracticable and we have therefore come to the conclusion that the only practicable way to preserve the limited exposure to risk of the contractor in the above example is to provide that the amount the lien claimant is entitled to must depend not on S's solvency, but on who, as between C and S, actually discharges the lien. In order for S to discharge the lien, the price should be $20,000; but in order for C to discharge it, the price should be the amount owing by C to S (provided this amount is not less than the statutory 15 per cent and no greater than $20,000).

The effect of this may be that in some cases C and S, by acting in collusion, will be able to clear the lien by payment into court of an amount less than the amount which ought to be paid in. In practice this will rarely, if ever, occur. Firstly, when liens are filed whilst the work is still in progress it is likely that in most cases C would still insist that S clear the liens if he wishes to continue to do work on that job. In that case, ahd where S is solvent, the proper amount will be paid into court. Secondly, if in an attempt to reduce the amount of MA's recovery, C clears the lien when it ought properly to have been cleared by S (i.e. S has paid nothing to SSA and is still solvent), MA should have a direct right of action against S.

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14. *See supra*, at p. 124 for recommendations concerning the manner of discharge of liens.

According to the terms of the trust provision,[15] it would appear that MA could be a beneficiary and S a trustee of sums in S's hands. It was held, however, in *Crane Canada Ltd.* v. *McBeath Plumbing and Heating Ltd.*[16] that the relationship of trustee-beneficiary exists only between people who have a contractual relationship. In principle, the Commission agrees with the implication of that decision, and it goes far to remove much of the obfuscation surrounding the wording of the trust provision. But we believe that in the circumstances now being discussed, it would be desirable to extend the trust provision to enable MA to sue S directly in order to recover the difference between the amount for which a lien is proved and the amount paid into court to discharge the lien. The effect of this would be that if MA's lien were removed by C by payment into court of C's holdback from S, when in fact S was still solvent and should himself have removed the lien, MA will be able to claim as a trust beneficiary for the difference between the amount which it would have cost S to discharge the lien and the amount it cost C to discharge the lien. In the result, we believe that the consequence of allowing C to clear the lien for a lesser sum than it would have required for S to clear it, will not be serious.

In making this suggestion that the trust provision be extended in this one respect beyond the limit indicated by the case law which has construed the trust provision, the Commission wishes to point out that the extonsion is only being made where the lien claimant is able to prove a valid lien and up to the amount he is entitled to recover by way of enforcement of the lien.

At the same time, we feel that if the lien claimant is to be permitted to pursue his rights as a beneficiary under a trust as a supplement to his lien rights, there is no advantage in requiring the lien claimant to exhaust his remedy by way of the enforcement of a lien before he proceeds against the trustee. The purpose of suggesting a right to claim as a beneficiary is to give a remedy in circumstances which justify that remedy because the action for enforcement of the lien has not resulted in a fair measure of recovery to the lien claimant. The policy is, therefore, to provide a supplementary remedy. Once the need for that remedy is perceived, however, it does not follow that it should be so structured that it cannot be pursued until the lien claimant has already recovered everything to which he is entitled by way of enforcement of his lien.

The Commission believes therefore that if MA registers a valid lien for $20,000 he should have two ways of proceeding. He should be entitled to enforce his lien in the normal way and he should also be allowed to claim against S as a trustee. Where S is solvent he will normally discharge the lien. If S fails to do so, and it fails to C to discharge it, he will be able to remove the lien by payment into court of the holdback he has retained from S. Normally this should yield all that MA is entitled to. But in the case now under discussion, where it does not (because the sum recovered is less than the sum owing to the person who employed the lien claimant), MA, as a beneficiary, will be entitled to proceed directly against S, as a trustee.

In addition, since money owed by S to SSA is money which a lien claimant in MA's position ought to be entitled to, there is no reason why Y should not pursue his right under the trust against S simultaneously with, before, or independently of, his right to enforce his lien. To pursue his trust rights against S, MA must hold a valid lien and the amount recoverable in the trust action should be the same as the amount recoverable in the lien action (the amount owing to the person who

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15. S. 3 of the Act.

16. (1965), 54 W.W.R. 19 (B.C.S.C.)

employed the lien claimant, up to a maximum of the amount of the lien). The lien claimant cannot recover twice, however, and anything recovered in the trust action must be brought into account in determining the amount for which the lien may be enforced and *vice versa*.

As a result of the suggestion that MA should be entitled to pursue both his lien remedy and the supplemental trust remedy, it is theoretically possible that a case may arise in which the amount for which judgment is to be given in the two actions is dependent each upon the other. This is because the total amount recoverable is constant, so that more recovered by way of one remedy means less recoverable by way of the other. Such a case is unlikely to arise in practice. It would require the coincidence of a large number of facts to do so. The Commission believes in that circumstance however that the lien claimant's entitlement should be satisfied firstly against S and secondly against C. But MA's right against C should only be reduced to the extent that he actually recovers against S, not simply by the amount for which he obtains judgment against S. This is because S will generally be insolvent, or nearly so, in the situation under discussion, and the right of action given to MA against S is intended not to deprive MA of his right to enforce the lien, but to supplement that right. It is only where the actual value of that supplementary remedy exceeds a certain figure that a reduction should be made in the value of the lien right; not simply where, in pursuance of the supplementary remedy, judgment is obtained against S.

The Commission also believes that the supplementary trust remedy should be available against a person whose holdback should have been used to discharge liens in a case where the result of more than one class of lien claimants claiming in combination has been that individual lien holders have failed to recover their just portion of the sum owing to the person who employed them.

The Commission suggests:

(1) Where the sum owing to the person [e.g. SSA in the diagram] who employed a class of lion claimants exceeds the sum owing to the person [S] who employed that person [SSA], the lien will be discharged if the person [C] who employed the second-mentioned person [S] pays into court an amount equal to the lesser of the two sums, even though the payment into court is intended to discharge the liens of more than one class of lien claimants, provided that the amount so paid into court is not less than 15 per cent of the value of the work done and materials supplied in connection with the contract between the second mentioned person [S] and the person [C] who employed him.

(2) Where the liens of a class of lien claimants have been discharged by payment into court of an amount less than the appropriate amount, or where the liens of more than one class of lien claimants have been discharged by payment into court of an amount less than the sum of the appropriate amounts, the person [S] who employed the person [SSA] who employed a class of lien claimants whose liens have been discharged shall be a trustee of any moneys he [S] has received in connection with the improvement in respect of which the class of lien claimants have or, before they were discharged, had valid liens; and the members of the class shall be beneficiaries of that trust and shall be entitled, in pursuance of their rights under the trust, to recover the appropriate amount from the trustee [S]; provided that the class shall not, as a result of enforcing both their rights of lien and their rights under the trust, recover a total amount

exceeding either the appropriate amount or the amount for which the members of the class have or, before they were discharged, had liens; and the trust, which shall be known as a "supplementary trust," shall be deemed to have existed from the time at which the first member of a class to file a lien filed his lien.

(3) Where, but for the proviso contained in the previous provision, the total amount for which a class of lien claimants is entitled to judgment might exceed either the appropriate amoutt or the amount for which the members of the class have or, before they were discharged, had liens, the judge shall order that the amount to which the class is entitled shall be satisfied first out of moneys subject to the supplementary trust; but before ordering any reduction in the amount recoverable by the class of lien claimants by way of enforcement of their liens consequent upon their obtaining recovery under the supplementary trust, the judge shall first be satisfied that the class has recovered or will in fact recover an amount sufficient to justify the reduction.

(4) In provisions (1), (2), (3) and (5), "a class of lien claimants" means all lien claimants, whether one or more, employed by the same person in connection with an improvement and "the liens of a class of lien claimants" means the liens claimed by the members, whether one or more, of that class.

(5) The "appropriate amount" means the value of the work done and materials supplied in connection with the contract between the person [SSA] who employed a class of lien claimants and the person [S] who employed that person [SSA] less any sum not exceeding 85 per cent of that value paid in good faith to the person [SSA] who employed the class.