

# LAW REFORM COMMISSION OF BRITISH COLUMBIA

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## Backgrounder

### LRC 7—Report on the Mechanics' Lien Act: Improvements on Land

Date: June 1972

In this report, the commission's focus is on the then-*Mechanics' Lien Act*<sup>1</sup> and, more particularly, on recommending changes to the act where it concerns improvement to land and to the statutory trust created by the act. British Columbia has had mechanics' lien (now called builders lien) legislation since the late nineteenth century. In broad terms, the effect of this legislation is to bring about a departure from the general principle of the law that, in the absence of security for a debt being obtained by bargaining for it, no security for that debt exists. The *Mechanics' Lien Act* (as it existed at the date of this report) creates this security by extending two distinct rights to participants in the construction sector. First, the act provides that all money received by a contractor or a subcontractor on account of the contract price must be held in trust, and the contractor or subcontractor may not appropriate that money to their own use until the workers, material suppliers, and subcontractors have been paid. Second, the act provides that the workers, material suppliers, subcontractors, and contractors that contribute services or material to a construction project are entitled to a lien on the building, the land, and the materials placed on the land. (A *lien* is a claim on the property of another to satisfy an unpaid debt that can prevent it from being sold unless the lien is paid off.) The rationale of the *Mechanics' Lien Act* is to protect participants in the construction industry, which are seen to lack the bargaining power to obtain security for their debts.

This report contains an introduction and ten substantive chapters. In chapter one, the commission observes the necessity of reform, noting first that past amendments to the act have been made on a piecemeal basis. Second, the provisions of the act are unsatisfactory from a technical standpoint. They create a structure of rights without examining the nature of that structure or the way it is intended to operate. Perhaps the most fundamental reasons, for reform, however, is that application of the act is resulting in injustices.

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1. The legislation is now called the *Builders Lien Act*, S.B.C. 1997, c. 45, and it differs considerably in substance from the early 1970s *Mechanics' Lien Act*.

In chapter two, the commission examines principles underlying the act. The report sets forth the common-law position; specifically, that in a buyer-seller relationship, an unpaid seller has a contractual remedy as against the buyer, but that creditors will share between them in proportion to the amounts of their respective claims. The commission observes that even if a seller and buyer contract for a form of security, unless the parties bargain for and agree to a priority, the seller will stand in no better stead than any other creditor if the buyer becomes insolvent. The effect of the act is to bring about a departure from the general common-law principle, that in the absence of security being obtained by bargaining for it, no security exists.

The legislation creates two different types of rights that may exist contemporaneously or apart from each other. This legislation is in addition to contractual rights and for the benefit of certain classes of people engaged in the construction industry. The report then outlines the structure of a construction contract in order to better illustrate the two different types of rights created by the *Mechanics' Lien Act*: (1) the trust provision; (2) the lien and holdback provision. The report states the basis of the act, which is effectively to inject into the construction context a statutory basis for the operation of the security system and the credit system.

Chapter three provides a history of mechanics' lien legislation, noting in particular, that the common law is silent on the issue of secured rights over construction assets. Legislation creating this particular type of priority originated in the USA, and was adopted in British Columbia in 1879. The report goes on to note 1939, 1948, and 1956 as years when particularly significant amendments were introduced: motor-vehicle provisions, trust provisions and holdback provisions, respectively.

Chapter four outlines recent reforms and proposals for the reform of mechanics' lien legislation in various Canadian jurisdictions—including British Columbia, Alberta, Saskatchewan, and Ontario. The commission notes that between 1923 and 1949, a series of draft acts was produced in the hopes of achieving uniformity throughout Canada.

Chapter five sets forth arguments both in favour of repealing and retaining the *Mechanics' Lien Act*. The main arguments cited in favor of repealing the act are as follows: (1) it slows down the flow of funds along the construction chain; (2) the act induces a false sense of security, insofar as some suppliers are willing to supply goods on credit to subcontractors without assuring themselves of the financial strength of the subcontractor they are supplying. They are induced to do so in the belief that *The Mechanics' Lien Act* provides sufficient protection should the sub-contractor default on payment; (3) The act's technical difficulties; (4) the act can be used as an instrument of blackmail. The act is unjust, insofar as it not only affords a measure of protection to a particular class of persons, which not only does not exist in other sectors, but operates to the detriment of other sectors of community.

In respect of arguments in favour of retention, the commission noted a case could be made that the special protection given by the act to persons in the construction industry is justified and should be retained. Effectively, the report notes that factual circumstances and legal relationships involved in a construction project create a difficult circumstance for the

subcontractor seeking security in return for a willingness to undertake the work. The commission then points out that to repeal the act and have the subcontractor to try and obtain a lien or charge against the land by agreement with the owner would likely result in the disappearance of any form of security for the subcontractor.

The commission concludes the chapter by stating that under the current circumstances, the commission does not recommend repeal, but rather substantial amendments. The rationale behind their conclusion is that the suggested reforms are beneficial, but the commission cannot demonstrate as a conclusively the balance of benefits lie in reform.

Chapter six begins by outlining the basic provisions and principles of a lien, and identifying groups within the construction industry who can claim a lien. The commission recommends including architects and engineers within the group of potential lien claimants. The commission then goes on to consider against whom a lien may be claimed, and the amounts able to be claimed. The chapter proposes that the contractor and subcontractor each be required to retain a holdback of 15% 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 sub-contractor's exposure to risk at the hands of lien claimants. The commission goes on to make recommendations regarding the protection of lien claimants; more particularly, where the owner and contractor are not dealing at "arm's length," and that where suspicions exist that the amount of the contract has been "fixed" at a deliberately low price and hence reducing the amount available to claimants, the amount of the holdback should be calculated on the basis of the actual value of the work done.

The Report then identifies three provisions for cancelling and discharging liens:

- (1) A general cancellation provision;
- (2) Provisions cancelling a lien by making a payment or giving of security;
- (3) Discharge by payment into court of the holdback.

The commission recommends in particular, alterations to provision concerning the giving of security—namely, that any security given by the owner (which may exceed the amount of the holdback) does not deprive the owner of protection vis-à-vis provisions that limit his liability-to the amount of the holdback.

In chapter seven, the commission makes recommendations regarding jurisdiction and venue as well as procedure and enforcement of a mechanic's lien. More particularly, the commission recommends abolishing the necessity of filing a *lis pendens* where a lien has been cancelled in accordance with the provisions of the *Act*, or where the lien amount has been paid into court. The commission also recommended that where the amount in a mechanic's lien act exceeds \$3 000, both the plaintiff and defendant should be able to recover costs.

Chapter eight of the report sets out the "labour and material payment bond" as an alternative to the lien holdback system. More particularly, a "labour and material payment bond"

requires that if the principal fails to pay the persons he employs to provide labour and materials, the surety (or guarantor) is liable to pay those persons up to an amount specified in the bond. The report goes on to outline the operation of the bond alternative to the holdback system, as proposed by the commission. The holdback scheme contemplates that each person in the construction chain will retain a holdback as a security for the person next in line and one below him. More particularly, the owner's holdback is intended to discharge liens of persons employed by the contractor—the holdback retained from the subcontractor, to discharge liens of persons employed by the subcontractor. Under the bonding alternative, the subcontractor can obtain a bond in lieu of a holdback.

Finally, chapter nine examines the trust provisions of the legislation. It begins by grappling with the fundamental question of whether the trust provisions should be retained in the proposed legislation. After concluding that, on balance, retaining the trust is beneficial, the commission goes on to make a number of proposals to fine-tune the operation of the trust.

### **Further Developments**

See *Builders Lien Amendment Act, 1984*, S.B.C. 1984, c. 16, s. 3 (in part); *Builders Lien Amendment Act (No. 2), 1984*, S.B.C. 1984, c. 17, s. 1 (in part) (now *Builders Lien Act*, S.B.C. 1997, c. 45).