“LIENING IN A NEW DIRECTION”: RECENT AMENDMENTS AND CASE LAW ON CONSTRUCTION LIENS

John Kulik
McInnes Cooper

with the assistance of Chris Wilson,
Kevin Gibson and Allan White

Canadian Bar Association - 2005 Annual Professional Development Conference

Friday, January 28, 2005
Halifax, NS

Introduction

Following the Law Reform Commission of Nova Scotia's recommendations for reform of the Nova Scotia Mechanics' Lien Act, R.S.N.S. 1989, c. 277, the Provincial Government introduced Bill 58, An Act to Amend the Mechanics' Lien Act during the Spring 2004 sitting of the Nova Scotia Legislature. The Bill was quickly passed as Chapter 14 of the Acts of 2004: the changes became effective as of January 1, 2005. Chapter 14 provides the first amendments to the province's construction lien legislation in 20 years, and the changes are significant. Even the title of the Act has changed: the Act is now known as the Builders' Lien Act. The purpose of this paper is to explain the effects of these changes with an emphasis on the new trust provisions. A brief overview of recent lien cases is also provided.

Appendix A: An Act to Amend the Mechanics' Lien Act, S.N.S. 2004, c. 14

Appendix B: Mechanics' Lien Act, R.S.N.S. 1989, c. 277 as amended (not including c. 14 amendments)

Timing Provisions

The time to register a lien has now been changed from 45 to **60** days from the last day of supply of labour or materials to a project. Also, a lien claimant now has **105** days (instead of 90 days) from the last day of work to perfect its lien by starting a Court action and registering a Certificate of Lis Pendens at the appropriate Registry of Deeds. (Reminder: Use the appropriate forms under the Land Registration Act or run the risk of your documents being rejected by the Registry and potentially missing a limitation period. See Appendix C for forms).

Reference: An Act to Amend the Mechanics' Lien Act, S.N.S. 2004, c. 14, ss. 7, 9, & 12.

It appears that the purpose of this amendment is to be better synchronize the lien period with the time for payment of accounts. Most accounts are not payable for at least 30 days if not longer. Now a potential lien claimant has more time to take the necessary steps to protect its position once it realizes that there are problems with an account. The

down side for contractors is, of course, that the period for maintaining the 10% holdback is now 60 days from substantial performance instead of 45 days. Therefore, contractors will be waiting longer than before for release of their holdback.

It is important to keep in mind that the time period for filing a lien is 60 days from the last date of work. Yet the period for maintaining the holdback is 60 days from substantial performance, **not total performance**. Section 13(1) of the Act defines "substantial performance" as follows:

> **Deemed substantial performance**
>
> **13 (1)** In this Section, a contract under which a lien can arise pursuant to Section 6 is deemed to be substantially performed
>
> (a) when the work or improvement 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 no more than two and one half percent of the contract price.

It is still entirely possible, for example, that a subcontractor on a project could file a valid lien more than 60 days after substantial performance at a point when the owner has already released the 10% holdback. In such circumstances, the owner has complied with the Act and the contractor's maximum claim against the owner would be for 2.5% holdback which the owner is to maintain until total performance. See Section 13(3) of the Act which states:

> **Holdback reduced to 2½%**
>
> **13(3)** Forty-five days after the contract is substantially performed the amount required to be retained pursuant to subsection (2) may be reduced to two and one-half percent of the value of the work, service and materials actually done, placed or finished and his balance of two and one-half percent may be retained by the person primarily liable upon the contract until all required work is performed completely.

In practice, many owners ignore at their peril the maintenance of a 2.5% holdback until total performance (see: Anixter Canada v. Phil Miller Electric at p. 22 of this paper).

Application to the Provincial Crown

Another important substantive development is the extension of the application of the Act to the Provincial Crown. The previous version of the Act did not state that it was applicable to the Crown nor did it impose any lien or holdback obligations on the Crown (which is a significant property owner in this province). Since the Act did not specifically state that it was applicable to the Crown, the rules of statutory interpretation dictate that it was not. The new amendments will make the Act binding upon the Crown but will not permit a lien to attach to Crown property. Instead, a contractor's lien will constitute a charge on the holdback that the Crown must now maintain.

The following are the relevant amendments with respect to the Crown:

> 3 (1) Nothing in this Act extends to any public street or highway or to any work or improvement done or caused to be done thereon.
>
> (2) A lien does not attach to and cannot be registered against the estate or interest in the land of Her Majesty in right of the Province.
>
> (3) Where the circumstances referred to in Section 6 apply to land in which Her Majesty in right of the Province has an estate or interest but Her Majesty is not an owner, the lien may attach to the estate or interest of any other person in that land.
> (4) Where Her Majesty in right of the Province is an owner, the lien does not attach to the land but constitutes a charge as provided in Section 13, and this Act applies without requiring registration pursuant to Section 18 of a claim of lien against the land.
>
> (5) Where the owner of a property is Her Majesty in the right of the Province, the claim for lien made in accordance with Section 19 or 20 may be served upon the Minister of Justice and Sections 24 to 29 apply mutatis mutandis.
>
> (6) Subject to this Section, this Act is binding upon Her Majesty in right of the Province.
>
> (7) Notwithstanding Section 18 of the Proceedings against the Crown Act, no action shall be brought against Her Majesty in

> the right of the Province under this Act unless thirty days previous notice in writing has been served on the Attorney General, in which notice the name and residence of the proposed plaintiff, the cause of action and the court in which it is to be brought shall be explicitly stated.

The question becomes what will one have to do to provide notice of a lien against the government held lien fund? It would be pointless to register a lien at the Registry of Deeds since a lien claimant has no right to claim against Provincial Crown land: in fact, section 3(2) of the Amendments forbids it. However, a lien claimant still has to give notice to the Crown containing the same information and within the same time period as if it had registered a lien. Notice is to be sent to the Minister of Justice: I suspect that various lawyers in the Department of Justice will be designated as recipients for these Notices. I would suggest that the best practice is to prepare the Mechanics' Lien in the form one would normally use and simply send it off to the Minister of Justice instead of filing it at the Registry of Deeds. This Notice of Lien must still be provided within 60 days of the last day of work.

Furthermore, an action to perfect the lien must be commenced within 105 days of the last day of work and a Certificate of Lis Pendens confirming that an action has been commenced must be provided to the Crown.

However, there is one added complication. Since in order to perfect the lien, one has to commence a Court action and the action will have to name the Province as a party, Section 3(7) of the Amendments requires that the Province be provided with 30 days "Notice of Intended Action" prior to any action being commenced. This in effect creates another deadline, one which is not specifically set out in the Act: within **75 days** of the last day of work on a project involving the Province, a Notice of Intended Action must be provided to the Province, following which one has to wait 30 days before starting an action to perfect one's lien.

It should be noted that Section 3(1) of the legislation states that "nothing in this Act extends to any public street or highway or to any work or improvement done or caused to

be done thereon". Accordingly, contractors who do work on road construction still cannot file liens with respect to provincially owned highways, even though the lien in question would only be against the lien fund and not against the road or highway itself. Furthermore, even the new trust provisions do not apply to road or highway work since "nothing in this Act" extends to road work. It is a bit of a mystery as to why the road construction industry has been denied the benefits of the Province's Builders' Lien legislation even when those provisions would create no interest in the roads themselves and hence no impact on public transportation.

Finally, the Act still does not apply to Federal Crown property.

Lien Sheltering

The Amendments have eliminated lien sheltering. At present, a lien holder who fails to register a lien within 45 days of their last day of work, or who has registered a lien but has failed to begin an action within the applicable period, is not necessarily deprived of lien rights. For example, Claimant A may "shelter" under the claim of another lien holder (Claimant B) if Claimant B has registered a lien in relation to the same property and has started an action and has filed a Certificate of Lis Pendens within the time period that Claimant A should have filed his lien (ie. within 45 days of Claimant A's last day of work).

Although the removal of the sheltering provision will reduce the avenues of recovery for potential claimants who have not complied with the Act's requirements, there is now added incentive for claimants to pursue their claims more diligently. Moreover, this amendment brings Nova Scotia in line with all other provinces in Canada, none of whom (with perhaps the exception of the Yukon) have sheltering provisions. Most importantly, there will far more certainty in the system: once a lien period expires, money can be paid out promptly without the lingering fear of a sheltered claim.

Reference: S.N.S. 2004, c. 14, ss. 11-15.

Elimination of Mechanics' Lien on Ships and Vessels

The Amendments will eliminate references to ships and vessels from the definition of the types of work which give rise to a lien. As the Act is generally applied to protect those persons in the construction industry who provide work, services and materials for the improvement of land or buildings, the deletion of references of ships, vessels and moveable property focuses the legislative scheme solely on the construction industry and brings the Act into conformity with lien legislation elsewhere in Canada.

Reference: An Act to Amend the Mechanics' Lien Act, S.N.S. 2004, c. 14, s. 6

Of course, the Act will not disentitle those involved in work on such property to a lien, but they will have to look elsewhere for that protection. For example, the Nova Scotia Liens Act, which is not yet in force, contains provisions which would govern the creation, registration and enforcement of liens in relation to moveable property. A statutory "right *in rem*" under the Federal Court Act (sometimes erroneously referred to as a "Maritime Lien") may also be available to those engaged in ship repair and related work. Additionally, the existence of a possessory lien, which would have effect for as long as the holder retains possession of the property, is also unaffected by the Amendments: See for example, s. 45 of the old Act.

It should be noted that there were certainly drawbacks with respect to application of the Mechanics' Lien Act to ships and vessels. For example, in what registration district would one file a lien on a ship especially if that ship is at sea? Furthermore, there is no "arrest" provision under the Mechanics' Lien Act to keep ships and vessels from leaving port. Unfortunately, there are drawbacks to the "right *in rem"* provided under the Federal Court Act. Although arrest of the vessel can take place, only a party with a direct contract with the owner of the vessel can make an arrest.

I note that when the two remedies were used in tandem, excellent and sometimes spectacular results could be obtained.

Information to be Disclosed

There are also changes in the information which must be made available to lien holders. Previously, Section 32 of the Act only entitled a lien holder to require an owner or its agent to identify the terms of the contract or an agreement between the owner and contractor, as well as to identify the amount due under the contract. The owner or agent then had a reasonable time to respond: if he failed to do so, or falsely stated that terms or amount owing, he would be liable for any loss suffered by the lien holder who made the demand for information. The Amendments expand these provisions, increasing the range of information that may be demanded to include the names of parties to a subcontract, the state of accounts between a contractor and sub-contractor or sub-contractor and supplier, a statement of whether a sub-contract has been certified as complete, and a copy of any labour and material payment bond posted by a contractor or sub-contractor. The period of time for responding to such demands for information is 21 days.

Reference: An Act to Amend the Mechanics' Lien Act, S.N.S. 2004, c. 14, s. 16.

Provisions for Arbitration

The Amendments also introduce provisions dealing with the arbitration of lien claims. In particular, provisions have been introduced to ensure that parties to arbitrations are not foreclosed from taking the necessary steps to preserve lien rights.

Reference: An Act to Amend the Mechanics' Lien Act, S.N.S., c. 14, s. 17

Previously, there was some confusion as to whether an arbitration clause in a contract which prohibited a party from commencing a legal action to enforce its rights (instead, the party had to resort to arbitration) had the effect of prohibiting a party from commencing a lien action and obtaining the necessary Certificate of Lis Pendens which it had to register in order to perfect its lien within the 90 day (now 105 day) period. That issue is now laid to rest.

Trust Provisions

By far the most significant change made to the legislation is that it introduces trust provisions to the Act. These trust provision, which appear immediately after s. 44 of the Act are virtually identical to those contained in Ontario's Construction Lien Act, R.S.O. 1990, c. C-3, ss. 7-13. Therefore the manner in which the Courts in Ontario have interpreted that legislation will be a good indication of how the new trust provisions will likely be applied by the Courts in Nova Scotia.

The Ontario Court of Justice explained the statutory scheme as follows:

> The trust provisions of the Construction Lien Act provide additional protection for trades and suppliers on construction projects beyond the protection provided by the right to file liens against the property. Essentially, the Act requires that a contractor or subcontractor who receives money on account of its contract on a project must use those monies first to pay those who provided services or materials on the project. A failure to do so will constitute a breach of trust for which, in certain circumstances, the directors, officers or controlling minds of a corporate contractor may be personally liable.

Reference: St. Mary's Cement Corp. v. Construc Ltd. (1997), 33 C.L.R. (2d) 234 (Ont. C.J. (Gen. Div.)) at para. 6

The Trust Obligation

In short, the Amendments to the Mechanics' Lien Act create a trust obligation on behalf of an owner (per s. 44A) and on behalf of contractors and subcontractors (per s. 44B). With regards to contractors and subcontractors, s. 44B (1) of the Act reads as follows:

> 44B (1) All amounts
>
> (a) owing to a contractor or subcontractor, whether or not due or payable; or
>
> (b) received by a contractor or subcontractor,
>
> on account of the contract or subcontract price of any of the purposes enumerated in Section 6 constitute a trust fund for the benefit of the subcontractors and other persons who have supplied

> services or materials to any of the purposes enumerated in Section 6 who are owed amounts by the contractor or subcontractor.

The obligations of the contractor as trustee are set out in s. 44B (2) of the Act:

> 44B (2) The contractor or subcontractor is the trustee of the trust fund created by subsection (1) and the contractor and subcontractor shall not appropriate or convert any part of the fund to the contractor's or subcontractor's own use or to any use inconsistent with the trust until all subcontractors and other persons who supply services or materials to any of the purposes enumerated in Section 6 are paid all amounts related to any of the purposes enumerated in Section 6 owed to them by the contractor or subcontractor.

The nature of a trust fund is such that the money contained in the fund is never really owned by the trustee, but is merely held in trust by the trustee in order to pay his/her contractors, subcontractors and/or other persons who have supplied services or materials to the project. **Therefore, for example, the money does not constitute a receivable that can be assigned by the trustee under a General Security Agreement, nor does the money become part of a bankrupt trustee's estate.**

Statutory Exceptions

There are limited exceptions which apply to reduce the trust obligations. To the extent that a trustee makes payments to beneficiaries out of non-trust funds, he may then reimburse himself out of the trust monies. Likewise, if the trustee borrowed money to pay trades and suppliers, the loan may be repaid out of the trust moneys. The relevant provisions of the Act for the purpose of this action are sections 44E (1) and (2) which state:

> 44E (1) A trustee who pays in whole or in part for the supply of services or materials to any of the purposes enumerated in Section 6 out of money that is not subject to a trust under this Act may retain from trust funds an amount equal to that paid by the trustee without being in brach of the trust.
>
> (2) Where a trustee pays in whole or in part for the supply of services or materials to any of the purposes enumerated in Section 6 out of money that is loaned to the trustee, trust funds may be applied to discharge the loan to the extent that the lender's money

> was so used by the trustee, and the application of trust money does not constitute a breach of the trust.

Duty of the Trustee

Courts have held that the duty of the trustee to preserve the trust fund for the benefit of workers and suppliers is a continuous one and does not cease until all work has been completed and all workers and suppliers have been paid amounts owing by the trustee.

However, in the recent decision of 1150402 Ontario Inc. v. Delfino, [2003] O.J. No. 183 (Ont. S.C.J.), Justice Stinson rejected the suggestion that a contractor was required to continue to hold money received from the owner in trust until the contractor was satisfied that every person down the construction chain had received all sums owing to them from all intermediate parties. The Court held the view that the beneficiaries were limited to persons who stand in direct privity with the contractor and who were owed amounts by the contractor: once a contractor has paid those below him in the construction pyramid, he has fulfilled his trust obligations. The contractor does not have to ensure that its subcontractors have paid their sub-subcontractors and/or suppliers.

Intermingling of Trust Funds

With regards to diverting trust funds for non-trust purposes, the court in St. Mary's Cement Corp. (supra at p. 9) held that a contractor is in violation of the Act and in breach of trust if the trust funds in respect to one project are used to pay suppliers on a different project or to pay other expenses of the contractor. The Court went on to state at paragraphs 35 and 36:

> Although there is no specific requirement in the Act that trust funds be segregated in a special bank account, a contractor who deposits trust funds into a general business bank account and intermingles them with funds from other sources does so at its peril.
>
> [...]
>
> A trustee has an obligation to protect the trust funds. Allowing trust funds to be intermingled with other monies and used for general

> purposes is inconsistent with the trustee's duty to maintain proper control of the trust funds: see *Air Canada v. M & L Travel Ltd.* (1991), 77 D.L.R. (4th) 536 at 556 [...] (S.C.C.).

In S. E. Rozell & Sons v. Groff (2000), 2 C.L.R. (3d) 58 (Ont. S.C.J.), Justice Quinn addressed the issue of intermingling of trust funds and came to the conclusion that intermingling, in and of itself, can amount to a breach of trust. However, the Court stated that there may be limited instances where the nature of the intermingling does not place the trust funds at risk. Nine months later, in RSG Mechanical v. ABCO Construction (2000), 5 C.L.R. (3d) 294 (Ont. S.C.J.), Justice Molloy concluded that although the Act does not require a trustee to maintain a separate trust account for each construction project in which trust funds are held, "a trustee who commingles trust funds from other sources does so at its peril."

Reference: D.W. Glaholt, "Managing Trust Funds: The New York Model" (Jan. 2002), 21 C.L.R. (3d) 74 at p. 9

These recent developments in the case law regarding the intermingling of trust funds serve as a warning that maintaining of a blended operating account places trust funds at risk and that, in and of itself, may constitute a *prima facie* breach of either the s. 44A owner's trust or the s. 44B contractor's trust.

It appears that the practice in New Brunswick has been not to maintain a separate trust account for contract payments. It is suggested that this may be a dangerous practice. Although it is certainly not necessary to open new trust accounts for every single project, perhaps the best approach would be to set up one trust account for all project payments received and have it segregated like solicitor's trust accounts. Records could then easily be kept of payments received into the account and payments made out of that account.

Overhead Expenses

There was for a time some confusion in the case law as to whether a contractor was entitled to a reduction from the trust funds held for payments made in respect of its

own overhead expenses. However, the weight of the case law now is that such payments are not to be deducted by the contractor until all subcontractors, suppliers, labourers, etc. are paid. Courts have consistently held that any payment of overhead costs is a payment inconsistent with the trust, and any such payments made out of trust funds are made in breach of trust. In St. Mary's Cement Corp. (supra at p. 9), the Court stated that payment out of trust funds for items such as payroll, insurance, rent, membership fees, interest payments on loans, legal and accounting expenses, advertising, entertainment expenses and the like are improper and constitute a breach of the trust provisions of the Act.

Reference: 802798 Ontario Ltd. v. McConnery (2003), 31 C.L.R. (3d) 316 (Ont. S.C.J.); Dietrich Steel Ltd. v. Shar-Dee Towers (1987) Ltd. (1999), 45 C.L.R. (2d) 178 (Ont. C.A.); Structural Contracting Ltd. v. Westcola Holding Inc., [2000] O.J. No. 2131 (Ont. C.A.); Tam-Kal Ltd. v. Stock Mechanical Inc. (1999), 50 C.L.R. (2d) 224 (Ont. C.A.); Home Depot Inc. v. Fielder Painting Inc. (July 12, 1995 Doc. 2927/91 (Ont. Gen. Div.); Heritage Masonry Ltd. v. Building Team Ltd. (1995), 28 C.L.R. (2d) 101 (Ont. Gen. Div.); St. Mary's Cement, supra.

In Andrea Schmidt Construction v. Glatt (1979), 25 O.R. (2d) 567 (H.C.), Justice Saunders stated at paragraph 12:

> It seems to be that the trustee is not free to divert trust funds for non-trust purposes merely because there are no current unpaid claims of beneficiaries. It is only when the work has been completed and materials have been supplied on the respective contracts and in each case paid for that the obligations to the trustee are satisfied and he is then free to appropriate or convert funds for other purposes.

There are some significant problems with Justice Saunders' comments in the Andrea Schmidt Construction (supra) decision. His Lordship seems to indicate that if a general contractor receives a draw from the owner and pays all current claims up to date, the general contractor cannot use the balance of the funds for its own purposes **until the entire contract is completed**. This would be very difficult to apply in practice, especially on lengthy construction contracts which may last over a year. A general contractor has to pay its staff and overhead expenses. If a general contractor is not entitled to access contract funds on a per progress payment basis (ie. after all

subcontractors and suppliers have been paid out of a particular progress draw), general contractors will end up having to finance construction projects to a degree never intended. It is doubtful general contractors can realistically comply with such a narrow interpretation of the trust provisions. It remains to be seen how a Nova Scotia Court will interpret these provisions.

It must be remembered that although a contractor may technically breach the trust provisions of the Act by taking steps such as paying overhead etc., as long as his/her subcontractors, suppliers, labourers, etc. are paid in accordance with their contracts on a timely basis, then even if a breach has occurred, there will be no loss and therefore no claim. It is only when a contractor is in financial difficulty and cannot make payments that the trust provisions will come into play.

Relationship Between the Trust Provisions and Lien Provisions

The Courts have held that the trust provisions of the Act constitute a separate code, and are in no way dependant upon the lien provisions of the Act. Therefore, in order for a trust to arise under the Act, it is not necessary for a valid mechanics' lien to exist.

Reference: Re Minneapolis-Honeywell, [1955] S.C.R. 694 (S.C.C.)

For example, in T.J.'s Electric Ltd. v. SAR Petroleum Inc. (2003), 32 C.L.R. (3d) 259 (N.B.Q.B.), although it was accepted that a lien under the New Brunswick Mechanics Lien Act was not applicable to Crown Lands, Justice Rideout stated that the trust provisions contained at section 3 of the Act were stand-alone provisions and were applicable to the Defendants in that case. The view that the provisions are a separate and distinct cause of action has been upheld in other court decisions as well.

Reference: Fundy Ventilation Limited v. Ferrigan Mechanical Contractors (N.B.) Ltd. (1982), 40 N.B.R. (2d) 484 (N.B.C.A.) at para. 23; Harding Carpets Ltd. v. Saint John Tile & Terrazzo Co. (1987), 78 N.B.R. (2d) 323 (N.B.Q.B.) at para. 59; McAvity v. Canadian Bank of Commerce (1959), 37 C.B.R. 1, affirmed 38 C.B.R. 10 (S.C.C.).

The Onus of Proof

There is an initial onus on a claimant to prove the existence of a trust under s. 44B of the Act. In order to discharge that onus, a claimant would need to show, for example: (1) that the contractor or subcontractor above the claimant in the construction pyramid received monies on account of its contract price for a particular project; (2) that the claimant supplied materials on that project; and (3) that the contractor or subcontractor owes money to the claimant for those materials. If these three elements are proven, the trust provisions of s. 44B come into play.

The onus then shifts onto the recipient of the trust funds to show that it has complied with its obligations as trustee of those monies by establishing that any payments made out of trust funds monies were to beneficiaries of the trust or were within the exceptions provided for in the Act. If there is no evidence that demonstrates that the conditions under s. 44E were met or nothing that proves that all recipients of trust funds were beneficiaries, then the recipient of the trust funds has failed to discharge its onus and will be found liable for breach of trust.

Damages

In breach of trust cases, the measure of the damages awarded by the courts is the amount of the beneficiary's loss attributable to the breach of trust. However, the trustee's maximum exposure, regardless of the size of the beneficiary's loss, is the amount that has been converted by the trustee to a use inconsistent with the provisions of the Act. For example, if a contractor receives $500,000 in trust funds and breaches the trust by disbursing $100,000 to non-beneficiaries, the maximum amount of damages that can be awarded to unpaid subcontractors is $100,000. This amount will have to be pro-rated between the claimant beneficiaries according to the relative size of their claims.

Reference: RSG Mechanical Inc. v. ABCO Construction Inc., [2000] O.J. No. 4287 (Ont. S.C.J.)

With regards to who is entitled to the money, the Courts have stated that the trust created by the Act is for the benefit of all unpaid subcontractors. Therefore, the fact that some or all unpaid subcontractors have not pursued their remedy at the time of trial does not negate the trustee's liability to them nor does it negate their right to make a claim. However, the unpaid subcontractors remain entitled to the moneys only so long as the trust fund has not been exhausted by payments to legitimate beneficiaries or by any other payments made in accordance with an order of the court.

Reference: Anron Mechanical Ltd. v. L'Abbe Construction (Ont.) Ltd. (1991), 46 C.L.R. 49 (Ont. Gen. Div.); Minneapolis-Honeywell Regulator Co. v. Irvine & Reeves Ltd., [1955] S.C.R. 694 (S.C.C.)

It is important to keep in mind that there is a first come, first serve aspect to the trust fund. For example, if a general contractor has received $100,000.00 and owes his subcontractors and suppliers $150,000.00, he will have met his trust obligations as long as he has paid out all the trust funds to legitimate beneficiaries. He does not have to prorate the money. Using the facts of the previous example, if there were three subcontractors who were each owed $50,000.00 and the general contractor paid two of them $50,000.00 and the other one nothing, the general contractor has met his trust obligations. Of course, he still owes the unpaid subcontractor $50,000.00 as a matter of contract. However, he cannot be pursued for breach of trust.

Personal Liability

The circumstances in which personal liability for breach of trust may attach to an officer or director are set out in s. 44G of the Act as follows:

> 44G (1) In addition to the persons who are otherwise liable in an action for breach of trust under this Act,
>
> (a) every director or officer of a corporation; and
>
> (b) any person, including an employee or agent of the corporation, who has effective control of a corporation or its relevant activities,

> who assents to, or acquiesces in, conduct that the person knows or reasonably ought to know amounts to breach of trust by the corporation is liable for the breach of trust.

Section 44G if the Act also states that whether or not a person has effective control of a corporation or its relevant activities is a question of fact and that where more than one person is found liable for a particular breach of trust, those persons are jointly and severally liable.

Courts in Ontario have held that whether or not the person actually knows that particular conduct might constitute a breach of the trust provisions of the Act is not determinative. If the corporation's conduct constitutes a breach of trust, and if the person **ought to have known** of the constituent factual elements of the corporation's conduct, then the requirements of s. 44G (1) are met.

Reference: BPCO Inc. v. Deelstra (1994), 19 C.L.R. (2d) 125 (Ont. Gen.Div.); St. Marys Cement, supra; Home Depot Inc. v. Fielder Painting Inc., supra; and Heritage Masonry Ltd. v. Building Team Ltd., supra.

Further, the Courts have held that ignorance of the law is no defence and that a person is deemed to have knowledge of a trust imposed by statute: See Air Canada v. M&L Travel Ltd. (1993), 108 D.L.R. (4th) 592 (S.C.C.) at 608.

Other Provinces

A look at some of the trust provisions found in other provinces can also be helpful when determining how the newly introduced trust provisions will likely be applied by the Courts in Nova Scotia. For example, although the wording of the trust provisions in the New Brunswick Mechanics Lien Act, R.S.N.B. 1973, c. M-6, is different than the wording used in the newly adopted Nova Scotia trust provisions, the same underlying principles seem to apply. In other words, the purpose of the trust provisions in other provinces is the same: to provide an additional layer of protection to suppliers of work, materials, and services beyond their lien rights.

Section 3 of the New Brunswick Mechanics' Lien Act reads as follows:

> 3(1) All sums received by a builder or contractor or a sub-contractor on account of the contract price are and constitute a trust fund in the hands of the builder or contractor, or of the sub-contractor, as the case may be, for the benefit of the proprietor, builder or contractor, sub-contractors, Workplace Health, Safety and Compensation Commission, workmen and persons who have supplied material on account of the contract or who have rented equipment to be used on the contract site, and the builder or contractor or the sub-contractor, as the case may be is the trustee of all such sums so received by him, and until all workmen and all persons who have supplied material on the contract or who have rented equipment to be used on the contract site and all sub-contractors are paid for work done or material supplied on the contract and the Workplace Health, Safety and Compensation Commission is paid any assessment with respect thereto, may not appropriate or convert any part thereof to his own use or to any use not authorized by the trust.
>
> 3(2) Every builder, contractor or sub-contractor who appropriates or converts any part of the contract price referred to in subsection (1) to his own use or to any use not authorized by the trust commits an offence punishable under Part II of the Provincial Offences Procedure Act as a category F offence and every director or officer of a corporation who knowingly assents to or acquiesces in any such offence by the corporation is guilty of such offence in addition to the corporation.
>
> 3(3) Notwithstanding the provisions of this section, where a builder, contractor or sub-contractor has paid in whole or part for any materials supplied on account of the contract or for any rented equipment or has paid any workman or sub-contractor who has performed any work or services or placed or furnished any material in respect of such contract, the retention by such builder, contractor or sub-contractor of any amount so paid by him shall not be deemed an appropriation or conversion thereof to his own use or to any use not authorized by the trust.

The courts in New Brunswick have interpreted these trust provision to signify that the statutory trustee has discretion in who gets paid out of the contract money, but the discretion is limited to those who were actually involved in the contract.

Reference: Fundy Ventilation Limited v. Ferrigan Mechanical (supra); and Brunswick Const. Co. v. Fundy Ventilation (1982), 136 D.L.R. (3d) 355 (N.B.C.A).

Furthermore, there is some authority for the proposition that, although a pro rata distribution is not required by the New Brunswick Act, the rights of unpaid creditors under other provisions of law might require a pro rata distribution. For example, if a trustee had entered bankruptcy, there would then arise a necessity to distribute the trust funds on a pro rata basis. This was considered, but not decided in Fundy Formwork v. Basic Management (1993), 137 N.B.R. (2d) 108 (Q.B.) where the court considered the decision in Anron Mechanical v. L'Abbe Construction (1991), 46 C.L.R. 49. There are a few cases where trust monies were divided pro rata (see Re Putherbough Construction (1958), 37 C.B.R. 6; Guaranty Trust Co. of Canada v. Beaumont et al., [1967] 1 O.R. 479). On the other hand, the Court in Crane Canada v. McBeath Plumbing and Heating (1966), 54 W.W.R. 119, would confine these cases to their own facts. The duty to divide the trust monies pro rata in those cases was imposed, not on the contractor, but in the one case on a trustee in bankruptcy and in the other on a trustee who held the money for the benefit of creditors.

Recent Developments in Nova Scotia Construction Lien Jurisprudence

W. Eric Whebby Ltd. v. Garden Crest Developments, [2003] N.S.J. No. 182 (C.A.) - At issue was whether the Plaintiff was allowed to correct their previously registered lien claim as to the date of last work, so that the filing of the Certificate of Lis Pendens was within the 90 day requirement specified in the Act. The Court found that the date of last work had actually been performed later than the day that was stated in the actual lien that was filed such that the chambers judge was acting within his discretion in correcting the misstatement.

TRAX Construction v. United Gulf Developments, [2003] N.S.J. No. 275 (S.C.) - United Gulf was developing a large piece of land into a subdivision. The subdivision had been divided into two phases of which Phase One was substantially finished. United Gulf had hired Trax as a contractor to complete trenching and road work on Phase Two. When it became apparent that Trax was experiencing problems paying their subcontractors they were dismissed by United Gulf. Trax filed a lien on both properties,

even though it had only worked on Phase Two, arguing that its work benefited Phase One. The fact that the two phases had been subdivided was significant because houses on Phase One were constructed and for sale before any work had ever been done on Phase Two. As such the Court held that land comprising Phase One could not be considered as land enjoyed with Phase Two. An order discharging the Plaintiff's lien on Phase One was granted.

Anixter Canada v. Phil Miller Electric, [2004] N.S.J. No. 201 (C.A.) - Anixter had supplied electrical materials to Miller who conducted work on a project for J.D. Irving. After some financial problems encountered by Miller, the project was largely completed, but Anixter still had significant amounts outstanding from the project and filed a lien. Irving paid money pursuant to the lien to Miller but not all of it made its way to Anixter. The facts indicated that Irving had, in effect, held back more than the statutory holdback of 2.5% after 45 days had passed since substantial performance. The Court found that where the owner retains more than the required hold back, the excess is still subject to a lien, but the owner may set off amounts owed to the owner by the general contractor against the excess over and above the 2.5% holdback. No set off was available against the 2.5% holdback itself.

Doug Boehner Trucking & Excavating v. United Gulf Developments, [2004] N.S.J. No. 67 (S.C.), supplementary decision reported at [2004] N.S.J. No. 345 (S.C.) - The Plaintiff brought a motion for summary judgment with respect to a lien that it had filed against the Defendant and sought to have the Defendant's counterclaim and claim for set-off dismissed. The Plaintiff had conducted work under three separate contracts for the Defendant all relating to road construction. The fill that the Plaintiff provided for some of the road work turned out to contain significant amounts of arsenic levels. The Defendant refused to pay any amounts owing under the contract citing a complete failure in consideration and then counterclaimed for the remediation costs. Leblanc, J. followed an earlier ruling by the Court of Appeal in P.P.G. Industries Canada Limited v. J. W. Lindsay Enterprises et al (1982), 52 N.S.R. (2d) 267 (S.C.A.D.) in finding that counterclaims and set-offs in actions under the Mechanics Lien Act are restricted to those

that arise out of or work done or materials furnished to the property in question, as between the parties to the original lien action. He then went on to review the law on legal and equitable set-off. After reviewing several authorities, Leblanc J. decided that the Defendants claim for set-off was not one that went to the very root of the Plaintiff's claim. The Plaintiff's application for summary judgment was granted and the Court ruled that the counterclaim and set-off could not be maintained in a Mechanics' Lien action. Earlier case law had hinted that Summary Judgment was not available in Mechanics' Lien cases.

TJ Inspection Services v. Halifax Shipyards [2004] N.S.J. No. 347 (S.C.) - This case dealt with whether or not a component of an offshore platform or the land it was constructed on could have a lien filed against it under the Mechanics Lien Act. The Defendant tried to summarily dismiss the lien claim and attempted to meet the burden of showing that there was no arguable issue for trial. The success of the lien claim centered on whether or not the component of the platform could be classified as an "erection" or a "vessel" under s. 6(1) of the Act. The Court found that the component was a chattel resting upon the land on which it was built and as such was not a structure covered by the Act and could not be subject to a valid lien. In light of the amendment to the Act providing that the Act no longer applies to ships and vessels, this case appears to be of academic interest only.

Conclusion

The Amendments to the construction lien legislation in Nova Scotia came into effect as of January 1, 2005. The most radical changes to the Act are the new trust provisions, which are designed to provide additional protection for trades and suppliers on construction projects beyond the protection provided by the right to file liens against property. These provisions create trust obligations on behalf of owners, contractors and subcontractors. Monies received on account of a contract on a project must be used to pay those below in the construction pyramid who provided services or materials on the project. Although there are a few statutory exceptions, a failure to pay such parties will

constitute a breach of trust for which, in certain circumstances, the directors, officers or controlling minds of a corporate contractor may be personally liable.

An examination of the recent jurisprudence regarding similar trust provisions indicates that the trend in Ontario is toward increased judicial support for breach of trust claims and limited judicial tolerance for defences. For example, the Courts in Ontario no longer allow the payment of overhead costs out of the trust funds and are increasingly warning that the running of blended operating accounts places trust funds at risk and that this may constitute a prima facie breach of trust.

The new amendments to what has become the Builders' Lien Act introduce significant changes affecting both claimants and those defending lien claims. These changes will have far reaching effects on participants in the Nova Scotia construction industry and deserve careful consideration.

(#13436861)