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BARRISTERS & SOLICITORS

clientbulletin




Commercial Leasing Update

Inside this issue:

Jackhammers, nail guns, power saws…ah…the sounds of fall in the city.

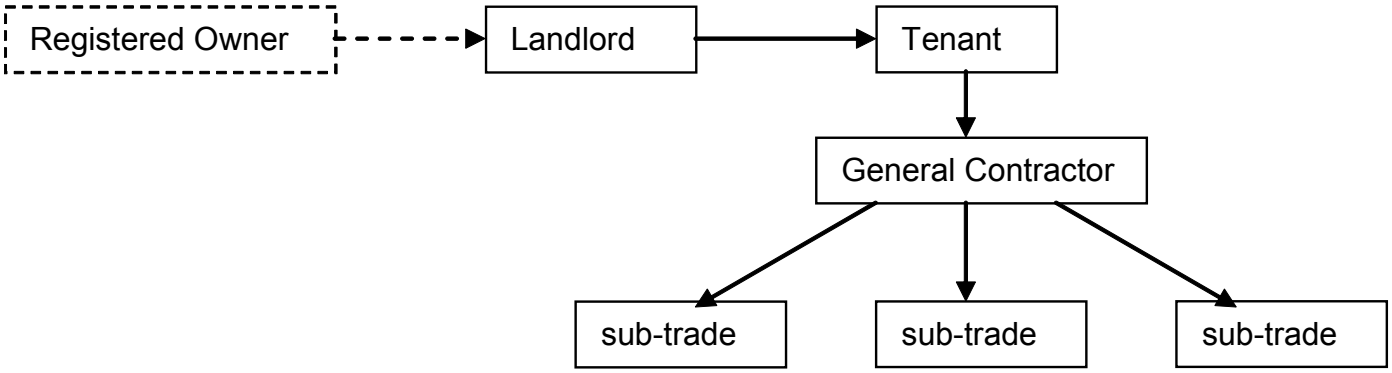
Recent reports estimate that residential real estate values will increase by 9.5 % this year, and that the average home price in Canada will top $300,000 for the first time. And we already know the state of affairs in commercial construction (especially in Calgary and Vancouver). But did you know that one of the natural consequences of construction is…you guessed it!....the construction lien?

Dealing With Construction Liens

By Michael R. Swartz

Imagine a hierarchy in which a landlord leases premises to a tenant who, in turn, (and possibly unbeknownst to the landlord), hires a general contractor to renovate the premises. The general contractor, in turn, hires sub-

trades to complete certain portions of the renovations (such as painters, electricians, and plumbers). It might be diagrammed as follows:



If the tenant fails to pay the general contractor or the general contractor fails to pay one of its sub-trades, the unpaid party could be entitled to seek relief under the *Construction Lien Act* (the "CLA") by registering a claim-for-lien against the "owner's interest" in the premises. The trouble is that the *statutory* owner, as defined by the CLA, is often not the same as the *registered* owner (found on the parcel register or PIN). As such, the landlord is commonly misnamed as "owner" in the ensuing lien proceedings, whereas the "owner" under the CLA is actually the party who contracted for the work (in our case, the tenant).

If faced with this situation, a landlord needs to consider, at a minimum, the following possibilities:

(A) Does the landlord need to have its title cleared?

(B) If such is the case, should it:

(1) pay money into court to clear its title?

(2) move to discharge the lien on the basis that it is not a *statutory* owner?

(3) move to discharge the lien on the basis that the lien claimant's rights have expired?

(C) Are there any outstanding issues regarding s. 19 or s. 39 notices under the CLA that would have an impact upon its decision?

(A) Does the landlord need to have title cleared?

Even sophisticated landlords panic upon discovering a lien on title. But the first question to ask is whether the title really needs to be cleared on an urgent basis. It may be that, unless the landlord is trying to sell or finance the property, or the landlord is being pressed to remove the lien (for example, by its own landlord in a head lease situation or on account of commitments it made in its mortgage documents), then time itself may resolve the issue without the landlord having to step in.

(B) (1) Should the landlord pay money into court to clear title?

The CLA recognizes that an unproven lien claim has the power to adversely affect an owner's interest

in its lands since the lien claimant is putting a charge on the land to act as security in the event that a claim is ultimately proven. So, to accommodate owners whose interests are adversely affected, the CLA permits anyone to substitute other security – by posting money with the *Accountant of the Superior Court of Justice* (i.e., "paying into court").

The immediate advantages to paying into court are: (a) it is fast; (b) title is cleared thereby; and (c) the cost of the motion is relatively inexpensive (especially if done in Toronto).

However, there are certain inherent risks in posting security with the Accountant:

- First, the payor generally must post money equivalent to the full amount of the lien claim **plus the statutory gross-up of 25%** of the lien claim for costs (up to a maximum of $50,000.00) – money, letters of credit or bonds can be tied up in court for a lengthy period of time and cannot be released (or cancelled, as the case might be) without court order.
- Second, the security stands **to the credit of the action** regardless of who posts the initial security. Therefore, even if a landlord is ultimately absolved of any liability, it cannot simply require the security be returned to it. If the action is ongoing between the tenant and the contractor, the money stays with the Court until the action is determined.
- Third, the liability is wider than one might first imagine. All lien claimants share pro-rata in the security posted. This can be even more surprising to the unwary where *sheltering* is an issue (that is, when another lien claimant shelters under another lien action and, therefore, is not required to commence any further formal action).

(B) (2) Should the Landlord move to discharge the lien on the basis that it is not a statutory owner?

A lien claimant's lien rights are defined by section 14 of the CLA:

> Creation of lien
>
> **14. (1)** A person who supplies services or materials to an improvement for ***an owner***, contractor or subcontractor, has a lien upon the interest of the owner in the premises improved for the price of those services or materials. [*emphasis added*].

Section 34(5) of the CLA (the enforcement provision) requires that every claim for lien set out information, including the name and address for service of the person claiming the lien, ***the name of the owner of the premises***, the name of the person for whom the services or materials were provided, the contract price or subcontract price, the amount claimed and a description of the premises.

This is why the definition of a statutory owner is critical. Section 1(a) provides:

> **"owner"** means any person, including the Crown, having an interest in a premises at whose request and,
>
> (a) **upon whose credit, or**
>
> (b) **on whose behalf, or**
>
> (c) **with whose privity or consent, or**
>
> (d) **for whose direct benefit,**
>
> an improvement is made to the premises but does not include a home buyer;

The problem lien claimants face in trying to lien only the leasehold interest lies within the e-registration ("e-reg") process itself. E-reg requires that the lien claimant enter the PIN of the premises. Of course, the PIN is assigned to the registered owner, thereby requiring the lien claimant to name the registered owner even if it doesn't wish to. There is a move afoot by the OBA – Construction Law Section, to rectify these problems. Nevertheless, it is incumbent upon a lien claimant to make sure it identifies whether it is claiming against the leasehold interest, the freehold interest or both. This issue was addressed in a recent case argued (successfully) by our firm:

> A claim for lien is a statutory remedy provided for by the *Construction Lien Act*. As a consequence in order for a claim for lien to advance the applicable statutory provisions must be complied with. […]
>
> It is common ground that [the moving party] is the owner of the title to and landlord of the lands and premises but that in itself does not fulfill the requirements of "owner" as defined in the Act. In the claim for lien, other than describing it as owner, none of the requirements set out in (a) to (d) of the definition of owner are set out. Further, pursuant to section 19(1), in order for the interest of [the landlord] as landlord to be subject to the lien to the same extent as the interest of the tenant the plaintiff must have given the subject to the lien to the same extent as the interest of the tenant, the plaintiff [i.e., lien claimant] must have given [the landlord] written notice of the improvement to be made. No evidence of such notice being given was tendered nor was there any suggest that the notice was given. On such facts, regardless of naming [the landlord] in the claim for lien and calling it "owner", the claim for lien fails against it. [*emphasis added*] **See: *Engineered Construction Limited v. Arena Entertainment Corporation et al.* [unreported]**

The question a landlord will undoubtedly ask itself is whether it should pursue such a motion. Put another way, the landlord might ask itself whether it has the right kind of evidence or argument to succeed at Court. The good news, for landlords at least, is that the CLA places the onus of establishing the lienability of the owner's interest on the contractor and not on the owner.

(B) (3) Should the Landlord move to discharge the lien on the basis that the lien claimant's rights have expired?

Lien claimants can lose their rights by waiting too long – the right to lien is strictly limited by time. Each lien claimant's lien rights start as soon as the claimant supplies materials or services for a project. But, unless those rights are preserved by registering a lien claim and affidavit against title, they will expire at the end of the very strict 45-day deadline set out in the CLA. Even after the lien claim has been registered, that claim itself will expire unless it is "perfected" by issuing a statement of claim in the right jurisdiction and registering a certificate of action on title within the next 45-day period. And even after the lien claim has been perfected, the lien can expire unless the action is ordered for trial or a trial date is set within two years from the date the statement of claim was issued.

Patience may prove to be an advantageous route for the landlord if the lien claimant is expected to be, or has proven to be, less then diligent in the prosecution of its lien claim. This is particularly advantageous in the latter case because it will not matter whether a lien was validly registered or not

– once lien rights have expired, they have expired forever regardless of the reason for their expiry.

(C) Section 19 Notices and Section 39 Requests for Information

Under Section 19 of the CLA, the lien claimant must notify the landlord, in advance, that the supply is going to take place, and that it intends to claim lien rights against the *freehold interest (the landlord's ownership interest, not the tenant's leasehold interest)*, in the event of non-payment. If the landlord receives such a notice from the contractor in accordance with the statute, and does not respond by disclaiming responsibility, in writing, **within 15 days of receipt** of notice, then the contractor and its trades may attach their liens to the underlying freehold interest.

The emphasis, of course, is on notice in advance of the improvement being made. The Court has been reasonably strict in requiring that the formal requirements of Section 19 be followed. While the best practice (from a lien claimant's perspective) is to use "form 2", set out in the CLA, use of the form is not required. Any form of notice will do so long as it is "arresting" and "attention-getting" and contains the following:

1. Details of the contract between the contractor and the tenant;

2. A warning about the liability of the landlord, directing the landlord to Section 19 (1) of the CLA;

3. A statement of the intention of the contractor to hold the landlord liable under this action; and

4. Specific mention of the landlord's obligation to disclaim responsibility in writing if it chooses to do so.

The case law in the area is clear that the formal written notice must make it "sufficiently distinct and memorable to the landlord that its freehold interest will be looked upon in the event of non-payment". Therefore, a landlord may reasonably rely on a lien claimant's failure to give it proper notice that it intended to hold the landlord liable for any issues regarding non-payment.

A lien claimant may also ask for, and be given, certain information regarding the factual and contractual relationships between various parties in a construction pyramid.

Section 39 of the CLA provides the lien claimant with the ability to demand and obtain certain information, such as the names of the parties to the contract, the contract price, the state of accounts between owner and contractor or contractor and sub-contractor, a copy of any labour material payment bonds (if any), and statements of whether a sub-contract has been certified as complete. Although it is doubtful that the landlord, who truly did not request any work, has any information to give, its best practice is to comply with the demand in a complete and timely fashion. *The reason is that it is difficult to remove a lien for tenants' improvements from an owner's title on a summary motion on the ground that no notice or no proper notice was given under Section 19 of the CLA especially if the landlord refuses to assist the lien claimant in determining whose interest it should be liening.*

The existence or adequacy of notice is usually seen as a genuine issue for trial and, thus, not susceptible to summary judgment. However, there are cost consequences of dragging a landlord through a lien trial where there is no, or inadequate, section 19 notice. This could be quite serious and costs could be awarded against the solicitor for the lien claimant as well as the lien claimant itself (in the appropriate circumstances). The reason is that the statutory

trade-off for this greater access to information in favour of lien claimants is greater direct responsibility for the contents of the claim for lien, the circumstances of its registration, and for the course of the lien action once it is under way.

The Final Word

Assuming that a landlord wishes to proceed with any such motion, it will do so by obtaining a motion date from the applicable Court. In Toronto, that would be obtained through the Construction Lien Court. Depending on the Court's availability, one could likely obtain a motion date in a matter of weeks. And depending on the complexity of the motion and the extent of any cross-examinations that are conducted on the supporting affidavits, the cost of such a motion will likely be somewhere between $5,000 to $10,000. Of course, if the landlord is successful, a Court will likely order that the losing lien claimant pay a portion of the landlord's legal costs – typically 50%.

The obvious advantage to pursuing this course of action is the ability to have an invalid lien dispensed with in a quick and cost effective summary procedure. The disadvantage is in the uncertainty of a Court's decision and the issue could possibly be ordered to be dealt with at a trial of the action. One factor that may assist a landlord in choosing whether to proceed with such a motion is whether the lien claimant has availed itself of discovering information that it is statutorily entitled to ask of landlords and other participants in the construction pyramid.

Michael's law practice is focused on serving the construction industry. He regularly acts on behalf of owners, landlords, contractors, subcontractors, suppliers and employees and has litigated before various boards, tribunals, and courts including the Ontario and Superior Courts of Justice, the Ontario Court of Appeal and the Federal Court of Canada. Michael also teaches construction law for the Ontario General Contractors Association and George Brown College. Michael can be reached at 416-947-5024, and by e-mail at mswartz@weirfoulds.com.

Trends and Developments

Urban design requirements are taking centre stage in cities across Canada, and have reached "the next level" in Toronto as of late. The Official Plan was approved in July 2006, along with the Tall Buildings Guidelines. The Design Review Panel Project is now on the horizon. The DRP Project derives from a notion that good design enhances quality of life. Its mandate will be to advise Toronto City Council; hopes are that it will assist Council in pursuing design excellence and creativity after public discussion. At present, its areas of interest are Etobicoke Centre, North York Town Centre, Scarborough Centre, Humber Bay, Fort York, and Lakeshore. The DRP itself is made up of architects, landscape architects and engineers, but some believe that future evolutions may be advised to consider adding designers and community members as other municipal review panels have done – it could make for more comprehensive discussions, and better results overall. Development and planning philosophers refer to "place making not object building", and have commented that the City of Toronto is staffed with "policy planners, not place planners", who are limited by a problematic ward system and outdated zoning bylaws. The DRP, however, currently remains an advisory panel only; it has no mandate to effect change. Since common wisdom is that urban design is relationships and interplay among space, people and buildings, and reflects a collective that is more than sum of parts, the DRP Project, which interposes urban design into the site plan approval process in certain areas of Toronto, has some people very excited. However, others have expressed concern that the DRP Project will serve only to extend an already lengthy site plan approval process; we will be interested to see how the pilot project plays out. In addition, as infrastructure weaknesses slow down more and more developments, will the DRP begin to recommend, and developers accept, that the developers should "front end" sewers and water, for example, to allow their lands to be developed (or developed more quickly)?

Definition of the Week:

"LEED Certification": LEED Certification is a system developed by the United States Green Building Council (USGBC, online at www.usgbc.org), whose membership comes from the development industry - architects, engineers and environmentalists. LEED Certification is applied to buildings and other developments, based on the ratings of such developments in a range of criteria related to sustainability, e.g. water and energy conservation. Developments are rated as Gold, Silver, or Bronze (the initial ratings), or as Platinum (introduced only a couple of years ago). LEED is currently discussed in terms of the costs and benefits of sustainability. Currently, it seems that the LEED system is not being used to drive legislation or litigation - it has been a factor in planning developments, but it has not been used as a basis for government regulations or ascribing liability (although a few U.S. states may be taking it more seriously in setting regulatory requirements).

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