NEWS Release

July 4, 2019

A CONSTRUCTION LIEN PRIMER – PART I

On July 1, 2018, most of the revisions of the overhauled *Construction Lien Act* (which was renamed the *Construction Act* (the "New Act")) came into force in Ontario. On October 1st of this year the prompt payment and adjudication provisions will come into force. This "News Release" is Part I of a three-part series: it deals with the situation where a tenant constructs improvements in accordance with its lease; Part II will explain the holdback system and how to remove a construction lien from title; and Part III will outline the prompt payment and adjudication regime (which is new not only to Ontario, but also to Canada).

LIEN RIGHTS AGAINST THE TENANT'S INTEREST

A contractor has the right to register a construction lien relating to the improvements it builds for a tenant, but the lien only affects the lease (the tenant's interest in the premises). While the lien does not affect the landlord's ownership interest in the premises except in the two instances described below, a landlord should nevertheless be concerned because the registration of the construction lien suspends the landlord's ability to terminate the lease for any default except a monetary default. In other words, if the tenant breaches its obligation to repair, to insure, to use the premises for a particular purpose, to abide by rules and regulations, to respect exclusive use restrictions, or if it fails to comply with any of its other obligations under the lease, the landlord cannot terminate the lease when a construction lien is registered on title due to work done for a tenant, if the rent payments are up to date.

LIEN RIGHTS AGAINST THE LANDLORD'S INTEREST

Before the New Act, there were two ways in which a tenant's contractor could claim a lien directly against the landlord's interest in the leased premises. Under the New Act, there are still two ways, but one of them is entirely new.

(1) CLAIMING A LIEN AGAINST AN OWNER

If there is a direct relationship between the landlord and the contractor, the landlord could be deemed to be an "owner". This situation has not changed under the New Act. Three hurdles must be met in order for the landlord to be deemed to be an "owner":

(i) the landlord must have an interest in the premises being improved;

(ii) the landlord must have requested the improvement; and

(iii) the improvement must have been made on the landlord's credit or on behalf of the landlord or with its privity or consent for its direct benefit.

The third requirement has been the subject of judicial interpretation and it is often not clear whether or when it is satisfied. For example, where a lease requires the tenant to construct improvements, provides for the landlord to pay a construction allowance and allows it to approve the plans for and supervise the construction, these facts are probably insufficient to satisfy the third requirement. Unless the landlord actually hires the contractor or performs a significant project management function whereby it deals directly with the contractor, the requirement may not be satisfied. However, exactly how much supervision or project management serves to push the landlord over the line is often unclear. Unfortunately, the ambiguity has not been remedied by the New Act. The only change made is that the definition of "improvement" now excludes ordinary day-to-day repairs. This means that only capital repairs are considered to be improvements and therefore subject to construction liens. The definition of a "capital repair" set out in the New Act is similar to the definition of capital repairs under generally accepted accounting principles. Unfortunately, the definition has been subject to fact-specific analysis and therefore, what actually constitutes a capital repair remains elusive.

(2) SECTION 19(1) OF THE OLD VERSION – NOTICE AND DISCLAIMER

The second situation in which the landlord's interest in the leased premises could be subject to a construction lien in favour of a tenant's contractor was found in Section 19(1) of the old Act. It provided that if the contractor gave written notice of the improvements to the landlord, the landlord's interest in the premises would be subject to the contractor's lien, unless, within 15 days, the landlord notified the contractor that the landlord would not be responsible. Generally, Section 19(1) was not very useful because, on receiving a notice, landlords typically fired off

a notice to the contractor disclaiming responsibility. Also, because the notice was not required to be given in a prescribed form, there was always a risk that some informal communication could be construed as a notice. In short, the old version of Section 19(1) caused more problems than it solved.

THE NEW VERSION – LIENS FOR 10% OF AN ALLOWANCE

Section 19(1) in the New Act is very different. It provides that if payment for all or part of an improvement is accounted for under the terms of a lease, or any renewal of the lease, or under any agreement to which the landlord is a party, and is connected with the lease, the landlord's interest will be subject to the contractor's lien to the extent of 10% of the amount of the payment. Even in those cases where the landlord has carefully avoided doing anything that would deem it to be an "owner" under the New Act, the contractor is able to register a lien against the premises for 10% of the amount of any tenant allowance payment. Furthermore, the New Act requires a landlord to disclose details of any construction allowance set out in the lease, if a contractor asks for the information.

WHEN DO THE LIEN RIGHTS EXPIRE?

The period for filing of a construction lien has been extended under the New Act from 45 days to 60 days. The 60-day period runs from the earliest of:

1. the date the contract is completed or abandoned;
2. the date the contract is terminated; and
3. the date a certificate of substantial performance is published.

If a certificate of substantial performance is published, a **second** 60-day period applies for work done after the publication of the certificate of substantial performance. For that work (often referred to as the finishing work) the 60-day period commences to run from the earlier of the date when the contract is completed or abandoned and the date the contract is terminated. Claims for liens made after the expiry of the applicable 60-day periods are not valid.

HOW DO OWNERS PROTECT THEMSELVES FROM CONSTRUCTION LIENS?

An owner under a construction contract is able to protect itself by maintaining the required holdbacks from the contract price. (The amounts of the holdbacks have not changed.) Also, when a construction lien is registered, the owner may have it removed from title to the premises by paying money into court or providing security using a so-called "bonding off" procedure. Removal of the lien under the bonding off procedure does not eliminate the contractor's claim; it simply substitutes the money paid into court or the security provided under the bonding off procedure so that the owner's interest in the premises is not subject to the lien.

Details concerning the holdbacks, changes to the definitions of substantial performance and completion of the contract, as well as the procedures for "bonding off" will be explained in the next installment. Stay tuned.

ANNOUNCEMENT

*Congratulations to **Francine Baker-Sigal, Jeanne Banka, Dennis Daoust, Melissa McBain, Natalie Vukovich and Deborah Watkins**, who were named in this year's Canadian Lexpert Directory of leading practitioners in Canada in the area of Property Leasing. **Daoust Vukovich** was also named as a leading firm for Property Leasing. The Lexpert Directory is the result of an extensive peer review survey process.*

This publication is a general discussion of certain legal and related developments and should not be relied upon as legal advice. If you require legal advice, we would be pleased to discuss the issues in this publication with you, in the context of your particular circumstances.

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