# Five Things Leasing Lawyers Ought to Know About the New *Construction Act*

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When landlords and tenants embark on improving their property, they wade into the world of construction – an industry known by lawyers for its web of contractual arrangements and complex statutory framework. When the property being improved is subject to a tenancy, additional challenges arise; more than one party has an interest in the real estate and the lease may restrict how improvements can be carried out. Lawyers who advise their clients on construction matters need a comprehensive understanding of how all these pieces fit together. Lawyers who are retained to advise on leasing matters, however, can sidestep much of the jumble by focusing on a few key concepts set out in the legislation governing construction in Ontario.

On the basis of an in-depth report[1] delivered to the Ministry of the Attorney General and Ministry of Economic Development, Employment and Infrastructure, in 2018 & 2019 the Ontario government implemented a broad range of amendments (the "**Amendments**") to existing construction legislation.[2] The stated goals of the Amendments were: to modernize the legislation, help make sure that workers get paid on time, and help resolve payment disputes quickly.[3]

Five things about the updated legislation that leasing lawyers ought to know are discussed in this paper.

## 1. NAME CHANGE

This paper's title refers to the "new" *Construction Act*.[4] However, the statute itself is not new. The *Construction Lien Act*[5] was introduced in Ontario in 1983. It has been in force, in one form or

* Thank you to Dennis Daoust, Natalie Vukovich and Heather Cross for their assistance in preparing this paper.
[1] Bruce Reynolds & Sharon Vogel, "Striking the Balance: Expert Review of Ontario's *Construction Lien Act*" (30 April 2016), online: *Ontario Ministry of the Attorney General* <https://www.attorneygeneral.jus.gov.on.ca/english/about/pubs/cla_report/>.
[2] The Amendments were made by the *Construction Lien Amendment Act, 2017*, SO 2017, c.24.
[3] "Changes to the Construction Act" (last modified 1 October 2019), online: *Ontario Ministry of the Attorney General* <https://www.attorneygeneral.jus.gov.on.ca/english/construction_law_in_ontario.php>.
[4] *Construction Act*, RSO 1990, c C.30 [*CA*].
[5] *Construction Lien Act*, RSO 1990, c C.30 as it appeared prior to 1 July 2018 [*CLA*].

another, ever since. However, the Amendments changed the name of the legislation, from the *Construction Lien Act* to the *Construction Act*. While the word "lien" was dropped from the name, the lien regime under the legislation was not. In fact, in many ways, the Amendments strengthened lien rights.

By way of reminder, a construction lien is statutory charge on an owner's interest in land in favour of those who supply labour, services or materials to an improvement of that land. Where a lien claimant remains unpaid, its ultimate remedy is the sale of the owner's interest to satisfy the debt.[6]

## 2. NO CHANGE TO DEFINITION OF "OWNER"

### (a) the definition

The lien-creating provision of the *Construction Act* provides that "[a] person who supplies services or materials to an improvement …has a lien upon the interest of the owner…".[7]

The definition of "owner" in the legislation is critical; it determines which interests in the improved land are subject to liens. The Amendments did not change this definition. Under the *Construction Act*, the definition of "owner" is:[8]

> *any person… 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…*

Accordingly, an "owner" need not be the registered or beneficial title holder of the parcel. A tenant that hires a contractor in respect of leasehold improvements, for example, will be an "owner" within the meaning of the legislation, such that the tenant's leasehold interest in the leased premises will be exposed to liens. Further, a landlord may fall within the definition of "owner"

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[6] Halsbury's Laws of Canada (online), *Construction Law*, "Remedies: Liens: Introduction: General Purpose of Liens" (IV.5.(1)(a)) at HCU-120 "Purpose" (2021 Reissue).
[7] *CA*, *supra* note 4, s 14 [emphasis added].
[8] *Ibid*, s 1(1).

with respect to the tenant's leasehold improvements. In such case, the landlord's reversionary interest in the improved premises will be exposed to liens as well.

### (b) when is a landlord an "owner"?

A review of judicial decisions on this topic demonstrates that whether a landlord meets the definition of "owner", in respect of improvements carried out by its tenant, depends on how involved the landlord is in the construction. Landlords get involved in their tenants' improvements to varying degrees. Any landlord would want, at the very least, to review its tenant's architectural plans. In many cases, a landlord's prior consent to those plans is required under the lease. Sometimes, landlords may be involved in financing the construction by agreeing to pay a "tenant improvement allowance". In some instances, landlords exercise a right to carry out portions of the tenant's work themselves, particularly where the work affects structural components or building systems that serve areas outside the premises. While there is no bright line marking precisely where a landlord crosses into the realm of "owner" in respect of its tenant's improvements, we have the following guidance from case law:

- a request may be express or implied[9]
- the absence of direct dealings is not determinative as to whether a "request" was made[10]
- landlord approval of drawings/plans of the improvements is not a request[11]
- mere knowledge of, or consenting to, the improvement is not a request[12]
- simply providing a tenant allowance is not sufficient to meet the credit requirement[13]
- for it to have been done on a landlord's behalf, likely requires that the requesting party is acting as the landlord's agent[14]

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[9] *Ravenda Homes Ltd. v. 1372708 Ontario Inc*, 2017 ONCA 834 at para 30.
[10] *Parkland Plumbing & Heating Ltd v Minaki Lodge Resort 2002 Inc*, 2009 ONCA 256 at para 67; *Roni Excavating Ltd. v. Sedona Development Group (Lorne Park) Inc*, 2015 ONSC 389.
[11] *Pinehurst Woodworking Co v Rocco*, [1986] OJ No 41, 13 OAC 121 (Ont SC H Ct J (Div Ct)) [*Pinehurst*]; *1276761 Ontario Ltd (cob GRM Contracting) v 2748355 Canada Inc*, [2006] OJ No 4740, 55 CLR (3d) 54 (Ont Sup Ct (Div Ct)), aff'g [2005] OJ No 2956 (Ont Sup Ct).
[12] *Roboak Developments Ltd v Lehndorff Corp*, [1986] OJ No 2681, 18 CLR 1 (Ont SC H Ct J) citing *MacDonald-Rowe Woodworking Co Ltd v MacDonald* (1963), 39 DLR (2d) 63, [1963] PEIJ No 4 (PEI SC).
[13] *Haas Homes Ltd v March Road Gym & Health Club Inc*, [2003] OJ No 2847, 29 CLR (3d) 243 (Ont Sup Ct) [*Haas Homes*].
[14] *Ibid*.

- consent does not mean simply approving or consenting to the improvement. A "significant element of direct contractual dealing" is required to say the improvement was made with the landlord's privity or consent[15]
- the benefit that a landlord may acquire as a result of its reversionary interest in the improved premises does not, on its own, satisfy the "direct benefit" factor. Some benefit beyond that incident to a reversioner is required[16]

Accordingly, the case law supports the position that simply approving plans and providing a tenant improvement allowance, without more, will not make the landlord an "owner". However, it's not black and white. Landlords wishing to avoid liens ought to avoid dealing directly with the tenant's contractors and playing an active role in the tenant's improvement process.

**(c) why does it matter?**

A lien that encumbers a landlord's reversionary interest in tenanted premises is problematic for a landlord for two reasons. First, the landlord's property is at risk of sale to satisfy the debt secured by the lien. Second, a lien may prejudice the priority of mortgages on the property[17], and therefore, most mortgages require that the borrowing landlord keep title free from all liens. Landlords can expect a failure to do so will not only result in the mortgagee's refusal to provide any further advances under the mortgage loan, but will trigger the mortgagee's remedies – including its right to call the loan.

Liens that encumber a tenant's leasehold interest are problematic for landlords also. Although a lien against the leasehold does not expose the landlord's freehold to risk of sale, two other problems arise. First, when registering a lien, claimants often don't specify whether the lien is as against the tenant's leasehold interest only, or the landlord's reversionary interest only, or both. So even where a landlord's interest is not validly subject to the lien, a lien may appear on title without specifying to whose interest it attaches. Its appearance will likely be enough to disrupt the landlord's normal course of business with its mortgagee. Second, the Amendments did not change sections 19(2) – (4) of the legislation, which continue, under the *Construction Act*, to restrict the

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[15] *Pinehurst*, *supra* note 11; *Haas Homes*, *supra* note 13 at paras 18,19; *Lincoln Mechanical Contractors v Cardillo*, 2011 ONSC 664 at para 30.
[16] *Pinehurst*, *supra* note 11*; DBM Heating & Air Conditioning Ltd v Lark Manufacturing Inc*, [1990] OJ No 319, 37 CLR 113 (Ont SC H Ct J).
[17] *CA*, *supra* note 4, s 78 (the details of which are beyond scope of this paper).

remedies available to a landlord when its tenant's leasehold interest is subject to a lien. These sections provide as follows:[18]

> *(2) No forfeiture of a lease to, or termination of a lease by, a landlord, except for non-payment of rent, deprives any person having a lien against the leasehold of the benefit of the person's lien.*
>
> *(3) Where a landlord intends to enforce forfeiture or terminate a lease of the premises because of non-payment of rent, and there is a claim for lien registered against the premises in the proper land registry office, the landlord shall give notice in writing of the intention to enforce forfeiture or terminate the lease and of the amount of the unpaid rent to each person who has registered a claim for lien against the premises.*
>
> *(4) A person receiving notice under subsection (3) may, within ten days thereafter, pay to the landlord the amount of the unpaid rent, and the amount so paid may be added by that person to the person's claim for lien.*

In effect, where a tenant's leasehold interest is subject to a lien, a landlord cannot terminate the lease for a default other than non-payment of rent. For non-payment of rent, the landlord cannot terminate the lease until it has given the lien claimant a 10-day period to pay the rental arrears to keep the lease extant.

**(d) what can be done?**

Since liens (whether on the landlord's interest or the tenant's interest) are problematic for landlords, it is typical for a lease to impose an obligation on the tenant to promptly remove from title liens arising from the tenant's work. A tenant's failure to satisfy this obligation typically triggers the landlord's right to remove the lien from title at the tenant's expense. To do so, a landlord may bring an ex parte motion, pursuant to section 44 of the *Construction Act*, to vacate (or "bond-off") the lien by paying into court the full amount claimed as owing, plus 25% (up to a maximum of $250,000. Note: this maximum was increased in the Amendments from $50,000) as

[18] *CA*, *supra* note 4, s 19(2)-(4).

security for costs.[19] The landlord will then seek to recover from the tenant, the amount paid into to court, plus legal fees to bring the motion.

Vacating a lien in this manner is not without risk to the landlord, as the amount paid into court serves as substitute security for the lien. If the landlord is unable to recover from the tenant the amount paid into court, the landlord will have exposed its own money to the lien claim. Accordingly, landlords may be reluctant to take this approach. On the other hand, vacating a lien may serve as an opportunity to turn a non-monetary default (i.e., the tenant's failure to have the lien removed promptly) in respect of which section 19(2) prevents the landlord from terminating the lease, into a monetary default, for which the landlord may terminate (subject to providing the lien claimant with the notice and cure period set out sections 19(3) and (4)). While this "monetising the breach" approach may be good strategy for a landlord in certain circumstances, it has not been established in case law that amounts payable to the landlord as reimbursement for the cost of vacating the lien will constitute "rent" within the meaning of the legislation.[20]

## 3. AMENDED SECTION 19(1) REGARDING TENANT'S WORK

### (a) allowances expose landlords to liens

Before the Amendments, section 19(1) set out a regime whereby a landlord's interest in leased premises improved by its tenant was subject to a lien, to the same extent as the tenant's leasehold interest, provided the contractor gave the landlord notice of the improvement and the landlord did not, within 15 days, respond advising that it assumed no responsibility.[21]

Save your stamps! The Amendments deleted this notice and reply-notice regime, replacing it with an entirely new concept. Section 19(1) now provides that a landlord's interest in leased premises improved by its tenant is subject to liens arising from the tenant's improvement to the extent of 10% of the tenant allowance or inducement payable under the lease. More precisely, the new section 19(1) states: [22]

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[19] *CA*, *supra* note 4, s 44.
[20] See *Pickering Square Inc v Trillium College Inc*, 2014 ONSC 2629, aff'd 2016 ONCA 179 where the Ontario Superior Court distinguished "rent" within the meaning of the *Real Property Limitations Act*, RSO 1990, c L15 from "Rent" as defined in the lease.
[21] *CLA*, *supra* note 5, s 19(1) as it appeared on 30 June 2018.
[22] *CA*, *supra* note 4, s 19(1).

> *If the interest of the owner to which a lien attaches is leasehold, and if payment for all or part of the improvement is accounted for under the terms of the lease or any renewal of it, or under any agreement to which the landlord is a party that is connected to the lease, the landlord's interest is also subject to the lien, to the extent of 10 percent of the amount of such payment.*

Accordingly, even where a landlord is clearly not an "owner" and its only involvement in the tenant's improvement is the commitment to provide an allowance, the landlord's interest will be exposed to the lien to the extent of 10% of the allowance.

**(b) allowance holdbacks?**

Given a landlord's exposure for 10% of the allowance, it would be prudent of the landlord to holdback at least that amount from any payments to the tenant until it is clear that the landlord will not be liable for any liens relating to the tenant's work. This holdback resembles the 10% mandatory holdback on progress payments under a construction contract (whereby 10% of the amount due under each instalment payment to the contractor as work proceeds is held back, and provided there are no liens, the aggregate holdback is released to the contractor when certain completion milestones are reached). The creation of lien exposure in the amount of 10% of the allowance suggests a similar progressive holdback ought to be applied to release of the tenant allowance. For example, where a lease calls for the allowance to be paid in instalments, section 19(1) suggests that a landlord should holdback 10% of each instalment, as security for its potential liability to lien claims under section 19(1). In fact, if a landlord is trying to retain 10% of the allowance as security to indemnify itself for any liens that may arise, it need only ensure that it doesn't release 10% of the allowance until it's confident there are no liens. It could pay up to 90% of the allowance at any point.

**(c) how much to holdback?**

Landlords seeking to hold back from the allowance sufficient security to protect their interests from a lien arising from the tenant's work ought to consider whether 10% of the allowance is enough. As discussed above, vacating a lien requires that the motioning party pay the "full

amount"[23] of the lien into court, together with 25% as security for costs. The amount of the lien is not related to the amount of the allowance (or 10% of it). In fact, the lien amount could vastly exceed the entire allowance, and that is without taking into account 25% as security for costs and the cost of bringing the motion. In bringing a motion to vacate a lien, the landlord may argue that the full amount of the lien as it relates to the landlord's interest is capped at 10% of the allowance,[24] and so it should be permitted by the court to vacate only that portion of the lien. If that argument is accepted by the court (bearing in mind that we have no case law on the new section 19(1) to consider), then 10% of the allowance would cover the lien amount. But the landlord would still have to reach into its own pocket to initially fund the 25% security for costs, not to mention the legal fees for bringing the motion.

Where the lease permits the landlord to effect a discharge of the lien by payment of the amount claimed directly to the lien claimant, 10% of the allowance would likely be sufficient security. It's worth noting, however, that section 19(1), does not expressly limit a landlord's total liability to liens arising from tenant improvements to 10% of the allowance. Rather, it says that the "the landlord's interest is also subject to the lien, to the extent of 10 percent of the amount of [the allowance]"[25]. Where there is more than one lien arising from the tenant's improvement, the wording of section 19(1) leaves open the argument that each such lien claim is secured against the landlord's interest in the premises to the extent of 10% of the allowance – an outcome which runs contrary to the recommendations in the report[26] that prompted the Amendments. All of which explaining why the most cautious landlord will not agree to pay out any portion of an allowance until all lien periods have expired.

**(d) conditions of release**

Releasing the amount that the landlord is holding back as security against liens ought to be conditional on confirmation that liens may no longer be registered in respect of the tenant's improvements. This means waiting the entire period during which liens may be registered, which

[23] *CA*, *supra* note 4, s 44(1)(c).
[24] Assuming the only basis for the lien is section 19(1) of the *CA* (i.e., that the claimant is not also arguing that the landlord is an "owner").
[25] *CA*, *supra* note 4, s 19(1).
[26] Reynolds & Vogel, *supra* note 1.

following the Amendments, is 60 days after total completion of the project.[27] Withholding the entire allowance until such time may not be acceptable to tenants. The tenant may argue that its legitimate need for part of the allowance as cash flow, outweighs the risk that the landlord will need the entire allowance to discharge liens. A landlord may barter withholding only a portion of the allowance for the right to discharge liens by payment directly to the lien claimant. This way, the landlord mitigates against the additional expenses that accompany vacating liens by payment into court.

Tenants are cautioned to carefully review the conditions to release of the allowance. A common condition is that the "lien period has expired with no liens having been registered". If a lien is registered (something which the tenant cannot prevent from occurring), the foregoing condition cannot be satisfied, ever. On the plain wording of the condition, the allowance would not be payable, even where the tenant satisfied its obligation to promptly have such lien removed. It is unlikely that the parties intend this outcome. A more precise way to state the parties' presumed intention is that "on the day following the period during which liens may be registered in relation to the tenant's work there are no such registered liens." That way, any liens that have come and gone will not prejudice releasing the remaining balance of the allowance.

## 4. DISCLOSURE OBLIGATIONS

Lien claimants, trust beneficiaries and mortgagees have long had the right under the *Construction Lien Act* to compel owners and contractors to disclose information and documentation relating to the construction contract, as such parties may require this information to enforce their rights under the legislation. In response to the new exposure of a landlord under section 19(1) brought about by the Amendments, landlords are now also subject to disclosure obligations. Section 39(1).4 of the *Construction Act* provides:[28]

> *Any person having a lien or who is the beneficiary of a trust under Part II or who is a mortgagee may, at any time, by written request, require information to be provided within a reasonable time, not to exceed twenty-one days… [b]y a landlord whose interest in a premises is subject to a lien under subsection 19 (1), with:*

[27] *CA*, *supra* note 4, s 31 (note: the Amendments increased this from 45 days, see *Construction Lien Amendment Act, 2017*, SO 2017, c. 24, s 26).
[28] *CA*, *supra* note 4, s 39(1).4.

*(i) the names of the parties to the lease,*

*(ii) the amount of the payment referred to in subsection 19 (1), and*

*(iii) the state of accounts between the landlord and the tenant containing the information listed in subsection (4.1)*

Subsection 39(4.1) lists the following information:[29]

1) *The price of the services or materials that have been supplied under the contract or subcontract.*
2) *The amounts paid under the contract or subcontract.*
3) *In the case of a state of accounts under paragraph 4 of subsection (1), which of the amounts paid under the contract or subcontract constitute any part of the payment referred to in subsection 19(1).*
4) *The amount of the applicable holdbacks.*
5) *The balance owed under the contract or subcontract.*
6) *Any amount retained under section 12 (set-off by trustee) or under subsection 17 (3) (lien set-off).*
7) *Any other information that may be prescribed.*

A party that fails to provide the information within the maximum 21-day deadline, or knowingly or negligently misstates the information, is liable to the requesting party for any damages suffered as a result.[30] As well, a requesting party can obtain a court order compelling the required disclosure and payment of legal costs for such order on a substantial indemnity basis.[31]

It is presumed that the drafters of the Amendments only meant to require "a landlord whose interest in a premises is subject to a lien under subsection 19(1)"[32] to provide the information in 39(4.1).3 (and maybe 39(4.1).7, i.e., "Any other information that may be prescribed"),[33] since a landlord that is not actively engaged in the construction project (i.e., a landlord that is not also an "owner" and whose involvement in the lien arises pursuant to section 19(1)) would likely not have

[29] *Ibid*, s 39(4.1).
[30] *Ibid*, s 39(5).
[31] *Ibid*, s 39(6).
[32] *Ibid*, s 39(1).4.
[33] As of the date of writing, no information has been prescribed under this section.

knowledge of, or access to, the rest of the listed information, which addresses payment details relating to the construction contract. So far there have been several corrections to the Amendments.[34] This provision, however, remains as is.

## 5. TRANSITION PROVISIONS

The Amendments came into force in two stages. The first set, addressing construction lien and holdback rules, came into force on July 1, 2018. The second set, addressing timing for payment and dispute resolution,[35] came into force on October 1, 2019. All the changes discussed in parts 1 - 4 of this paper came into effect in the first stage, on July 1, 2018. For the most part, construction contracts entered into after this date will be subject to the Amendments. However, there is a little wrinkle that leasing lawyers ought to know about.

Section 87.3(1) of the *Construction Act* provides as follows: [36]

> *This Act and the regulations, as they read on June 29, 2018, continue to apply with respect to an improvement if, (a) a contract for the improvement was entered into before July 1, 2018… or (c) in the case of a premises that is subject to a leasehold interest that was first entered into before July 1, 2018, a contract for the improvement was entered into or a procurement process for the improvement was commenced on or after July 1, 2018 and before the day subsection 19(1) of Schedule 8 to the Restoring Trust, Transparency and Accountability Act, 2018 came into force* [being December 6, 2018].

This complicated transition rule arose because subsection 87.3(1)(c) initially stated that the Amendments did not apply to an improvement if the improved premises is subject to a lease that was entered into before July 1, 2018.[37] Given that leases are frequently long-term relationships, this meant that well after the Amendments came into effect, improvements to leased premises may be subject to the pre-Amendment legislation, regardless of when the construction was taking place. This issue was corrected by subsequent legislation[38] that makes the timing of construction a

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[34] By virtue of the *Smarter and Stronger Justice Act, 2020,* SO 2020, C. 11, *Protecting What Matters Most Act (Budget Measures), 2019*, SO 2019, C. 7, and *Restoring Trust, Transparency and Accountability Act, 2018*, SO 2018, c.17, Schedule 8 [*Restoring Trust Act*].
[35] *CA*, *supra* note 4, Part I.1 (Prompt Payment) & Part II.1 (Construction Dispute Interim Adjudication).
[36] *Ibid*, s 87.3(1).
[37] *CA*, *supra* note 4 as it appeared between 1 July 2018 and 5 December 2018.
[38] *Restoring Trust Act*, *supra* note 34, Schedule 8.

relevant factor. However, in what appears to be a desire to avoid retroactive application of the correction, it states that the pre-Amendment legislation will continue to apply to improvements of premises under leases entered into prior to July 1, 2018, where the contract for the improvement (or procurement process) was entered into prior to enactment of the correction on December 6, 2018. The result is that the Amendments apply to all construction projects, unless the lease predates July 1, 2018 and the construction contract was entered into prior to December 6, 2018.

## Conclusion

Outlined above are five things leasing lawyers ought to know about the new *Construction Act*. The thrust of the take-aways is that a landlord may be liable in respect of liens relating to work done by its tenant, so the lease should provide the landlord with confidence that liens will be promptly removed from title and the landlord will be insulated from liability relating thereto. Tenants need a reasonable opportunity to address liens and avoid harsh consequences under their leases, as they have no legal means to prevent liens from arising.

In addition to the changes outlined in this paper, the Amendments introduced several broad-ranging changes that impact how construction is carried out in Ontario. Among the changes are a pair of complex regimes[39] aimed at expediting and facilitating payment to contractors. These Amendments have heightened the need for "owners" (landlords and tenants alike) to have their construction contracts reviewed with their interests in mind.

[39] The so-called "Prompt Payment" & "Adjudication" regimes, *supra* note 35.