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Prior to 2013, Mr. Heintzman practiced with McCarthy Tetrault LLP for over 40 years with an emphasis in commercial disputes relating to securities law and shareholders' rights, government contracts, insurance, broadcasting and telecommunications, construction and environmental law. He has acted in trials, appeals and arbitrations in Ontario, Newfoundland, Manitoba, British Columbia, Nova Scotia and New Brunswick and has made numerous appearances before the Supreme Court of Canada. He was an elected bencher of the Law Society of Canada for 8 years and is an elected Fellow of the American College of Trial Lawyers and of the International Academy of Trial Lawyers.

Thomas Heintzman is the author of *Heintzman & Goldsmith on Canadian Building Contracts*, 4th Edition which provides an analysis of the law of contracts as it applies to building contracts in Canada.

Trust Fund Obligations Continue After A Lien Bond Is Filed: Supreme Court Of Canada

The Supreme Court of Canada recently released its highly anticipated decision in *Stuart Olson Dominion Construction Ltd. v. Structal Heavy Steel*. The court has held that the trust fund obligations on a construction project did not terminate when the contractor filed a bond in respect of the subcontractor's lien.

This decision is of fundamental importance to building contracts and construction projects. It means that, even after posting a bond for a subcontractor's or supplier's goods and services, an owner and contractor must continue to hold and pay funds due in respect of the construction project to those who are entitled to those funds down the payment chain. They cannot rely upon the bond as discharging that obligation.

Those sympathetic with the contractor's position may assert that piling the trust fund obligation onto the owner or contractor once a lien bond has been filed is burdensome and unfair. However, the Supreme Court held that enforcing trust fund obligations in addition to the lien rights fortifies and strengthens the whole statutory regime.

Background

Stuart Olson Dominion Construction Ltd. (then known as Dominion Construction, and referred to herein and in the judgment as Dominion) was the general contractor for the construction of a new football stadium for the University of Manitoba. Structal was its structural steel subcontractor. Structal filed a builder's lien against the property. Dominion filed a lien bond for the amount of Structal's lien claim. Structal approved the bond and vacated its lien. Dominion continued to receive progress payments from the Owner. Structal asserted that Dominion was still required to comply with the trust provisions of the Act even though a bond had been provided for its lien. Dominion refused to make further payments to Structal and maintained that it had a set-off against the monies claimed by Structal, that there was no breach of trust, and that Structal was fully secured by the lien bond.

Structal notified the owner that it should withhold a \$3.5 million payment from Dominion or it would bring a claim against it for violation of the trust provision of the Act. The owner then required Dominion to bring an application in the Manitoba Court of Queen's Bench seeking a declaration that it had satisfied its trust obligations to Structal. If that order had been granted, then the owner could have used those withheld monies to pay other trust claimants and then other creditors. Structal then filed its own motion requiring full payment of its past-due invoices, without deduction or set-off, upon Dominion receiving the funds from the Owner.

The motion judge held that the filing of the lien bond extinguished the trust obligations of Dominion under the Manitoba **Builders' Liens Act** (the Act or *BLA*). The Court of Appeal reversed this decision, holding that the subcontractor's right to enforce a statutory trust was entirely separate from its right to file a lien claim, and that the subcontractor was entitled to enforce both rights even though a lien bond had been provided to secure the lien claim.

Decision of the Supreme Court of Canada

The Supreme Court recognized that there were two preoccupations of the construction industry at stake in this case:

First, ensuring payment of contractors and subcontractors; and

Second, encouraging liquidity in the flow of funds during the job.

The question in the present case was whether protecting the first preoccupation, by enforcing the trust claim, would interfere with or jeopardize the second, the flow of funds during the project. The Supreme Court found no such interference or jeopardy. Indeed it found that enforcing the trust fund provisions in this situation would enhance, while not enforcing whose provisions would undermine, the purpose of the statute:

“The purpose of the statutory trust was articulated by the Manitoba Court of Appeal in *Provincial Drywall*: “The trust provisions are designed to help assure that money payable by owners, contractors and subcontractors flows in a manner which is in accord with the contractual rights of those engaged in a building project and it is not diverted out of the proper pipeline”.....Finding that a trust claim is extinguished by filing a lien bond would undermine this purpose. A lien bond merely secures a contractor’s or subcontractor’s lien claim rather than satisfying it through payment and it does not extinguish the owner’s or contractor’s obligations under the statutory trust. The filing of a lien bond has no effect on the existence and application of the trust remedy.” (paras. 40-41)

The court noted that this conclusion is consistent with the word “all” which is used twice in section 4(3) of the Act. That subsection requires that the contractor not divert trust funds for its own use until all subcontractors have been paid all amounts owing to them.

The court noted that in Manitoba, the trust provisions were formerly contained in ***The Builders and Workers Act***, while the lien provisions were found in ***The Mechanics’ Liens Act***. In the statutes of Manitoba 1980-81, the two statutes were repealed and incorporated into the Act. But, as the court said, “the legislature did not expressly delineate how the lien and trust provisions were to interact in situations such as this case, where both remedies are pursued at the same time by a contractor or subcontractor.” Accordingly, while Dominion submitted that the trust fund provision was a secondary mechanism designed to protect lien rights and provided no wider protection, the court found no basis for that submissions: “The trust remedy originated in a statute that did not provide a lien mechanism and it was not altered to limit its applicability when both were incorporated into the *BLA*. Rather, both remedies exist independently.” (para. 35)

The court also noted that the two provisions contain different rights and affect different persons:

“The lien provisions do not impose obligations on contractors or subcontractors with respect to funds received. Trust funds, on the other hand, cannot be appropriated for other purposes until all subcontractors, all persons who have supplied materials or services have been paid (s. 4(3)(a)). Moreover, pursuant to s. 16 no lien can encumber the interest of the Crown, a Crown agency, or a municipality. There is no similar exclusion with respect to the trust provisions of the Act (see s. 3(1)).” (para. 32)

The court accordingly concluded:

“Nothing in the *BLA* suggests that the lien and trust provisions do not remain as two separate remedies. This is not to deny that a contractor or subcontractor may have both a lien and trust claim and that the funds sought under each remedy may be the same. But this does not change the fact that the claimant has access to both of these remedies.” (para. 38)

The court then addressed Dominion’s submission that the filing of the lien bond terminated the subcontractor’s trust fund rights. It rejected that submission for two reasons.

First, it held that if Dominion’s submission were correct, then if the subcontractor’s lien action failed (because, for instance, it had filed the lien claim late), then the subcontractor would also lose its trust fund rights. That result was clearly not envisaged by the legislation which contemplates that the two remedies may be independently asserted.

Second, the court rejected Dominion’s submission that maintaining the separate enforceability of the trust fund and lien claims would result in double payment of the subcontractor when the owner provides a lien bond and also has trust funds or is receiving trust funds from the owner. It did so by making two points.

First, a lien bond is not payment to the subcontractor, but only a promise of payment by the bonding company if the subcontractor succeeds in its lien action.

Second, the decision to obtain a lien bond, rather than pay the trust monies into court, is one for the contractor or owner to make. While that choice may result in double security, it does not result in double payment:

“There may be circumstances where a contractor will choose to maintain double security where there are lien and trust claims for the same work, services, or materials, by acquiring a lien bond while still holding trust funds. However, a contractor can avoid double security by paying cash into court pursuant to s. 55(2) instead of depositing a lien bond.....So long as the trust funds themselves are deposited with the court, the funds are secure and the trust has not been breached....A lien bond involves only an assurance that the surety will pay the amount of any lien judgment should the lien defendant fail to do so. The bond does not constitute security for the trust claim and does not result in the protection of the actual trust monies at issue. An owner, contractor, or subcontractor who chooses to file a lien bond with the court instead of depositing the funds at issue must maintain the trust fund in addition to the bond.” (paras. 46-47)

The court concluded with the observation that:

“Dominion chose to provide security by way of a lien bond rather than payment of funds into court. It is true that it paid premiums for that bond which are not recoverable, but that is simply the cost of the security which it chose to provide. Structural will not receive double payment.” (para. 49)

Discussion

There are many interesting points to discuss about this decision, but here are a few:

1. It is important to remember that, assuming that the owner pays the monies on the project in accordance with its statutory obligations, the owner will only be liable for the holdback. In Manitoba, the owner's holdback is 7.5 percent of the monies due under the main contract, and in Ontario and most other provinces the holdback is 10 percent. So normally, by its lien the subcontractor is seeking to protect its right to that holdback in the owner's hands. However, the trust provisions apply to any monies due on the project up and down the pipeline of payment. So if the contractor's position had been upheld, that would have dramatically limited the trust fund rights of subcontractors, sub-subcontractors and suppliers.
2. In some provinces, such as Alberta and Ontario, the subcontractors all share in the monies paid into court or protected by security such as a lien bond, even if those monies or that security are initially paid or provided to take one particular lien off the title to the property. In Saskatchewan, it is only the lien claimant whose lien is discharged by payment into court or by provision of security who is entitled to the money in court or other security, and in Manitoba, New Brunswick and Prince Edward island the lienholder whose lien is discharged by the payment into court or provision of other security has a first charge on those monies or security. So, the argument that a lien bond is not payment, and far from it, is even stronger in the former provinces than the latter.
3. The Supreme Court noted that, In Manitoba the lien provision and the trust fund were in different statutes as recently as 1981. In other provinces, such as Ontario, the lien and the trust fund provisions have been in the same lien statute for a long time. The Supreme Court noted that the legislative history in Manitoba supported its conclusion that the lien rights and trust fund rights are entirely separate, and that accordingly the trust fund rights are not eliminated by the provision of a lien bond. However, it seems unlikely that this distinction will make any difference in interpreting these lien statutes. The reasoning of the Supreme Court about the distinction between lien rights and trust fund rights appears to apply to all those provincial statutes.
4. Trust fund rights start at different levels in different provincial statutes. In some provinces, they start at the owner's level. Thus, in Manitoba, monies received by the owner that are to be used in the financing of the improvement, or are in the hands of the owner and payable to a contractor on the basis of a certificate of a payment certifier, are trust funds. In Ontario, the trust fund remedy was first introduced at the contractor level in 1942, and expanded to the owner level in 1969. The regime in Nova Scotia and Saskatchewan is similar to the present regime In Manitoba and Ontario. In other provinces, such as Alberta, the trust fund starts at the contractor level, and it is monies received by the contractor after a certificate of substantial completion has been issued that are trust funds for the benefit of persons who have performed work or provided services on the project. This difference may have been very material in the

present case. If the trust fund obligation only commenced if and when the monies were paid to the contractor Dominion, then Structal may have had no right to give notice to the owner and demand that the trust fund rights be adhered to at that level. If that is so, then there may be “leakage” in the payment pipeline at the owner’s level in some provinces that this decision will not address. One wonders whether, in those provinces where the trust fund remedy starts at the contractor level, the legislation should be amended to move that remedy to the owner level for the sake of consistency across Canada and to ensure that the payment pipeline applies to all levels of the project.

5. An underlying but unstated issue in this case was whether the imposition of the subcontractor’s trust fund rights, in addition to its lien rights against the land or the lien bond, would be unfair, or commercially unreasonable by interfering with the flow of funds during the construction project. In the absence of proof of those sort of circumstances, the wording of the statute showed that the subcontractor was entitled to assert both rights. The owner and contractor were not able to show such unfairness or commercial unreasonableness. On the face of the court’s judgment, there is nothing to indicate that they sought to show that the flow of funds would be interfered with or jeopardized; and the court found that the monies due under the main contract could be paid into court so that no double payment would occur. The court was not impressed by any unfairness arising from paying a premium for the lien bond rather than paying the money into court. That was simply a business, cash flow and financing decision for the contractor. In the result, there was no commercial unreasonableness to the subcontractor’s assertion and, in the court’s view, much to support it in terms of keeping the monies due on the project in the payment pipeline.

See *Heintzman and Goldsmith on Canadian Building Contracts*, 5th ed. Chapter 16, parts 4(m) and 6.

***Stuart Olson Dominion Construction Ltd. v. Structal Heavy Steel*, 2015 SCC 43**

Construction and builders’ liens – trust fund provisions – lien bonds

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