Using lien bonds on Crown Lands – Is there a difference?

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“Ensuring payment of contractors and subcontractors and encouraging liquidity in the flow of funds to them are both significant preoccupations in the construction industry.” The opening sentence of the 2015 Supreme Court of Canada decision in *Stuart Olson Dominion Construction Ltd. v. Structal Heavy Steel* 2015 SCC 43 (*Stuart Olson*) succinctly and effectively sets out what is, in practice, a more nuanced “preoccupation” than it may seem.

One of the primary disruptors of liquidity and the flow of funds on a construction project is the registration of a lien. The effectiveness of the construction lien is precisely *because* of its impact on the flow of funds on a construction project. Typically, under provincial lien legislation, an owner is required to withhold a certain percentage from payments (commonly referred to as holdback) to a contractor, which varies from province to province (for example, in Ontario it is 10 per cent, while in Manitoba it is 7.5 per cent). When a subcontractor registers a lien against a project, this dynamic changes, and an owner is typically required to withhold, in addition to the legislative holdback, funds sufficient to satisfy the total amount of the claims for lien registered.

This results in a disruption in the payments to a contractor, and can impact work on a project. As acknowledged by the Supreme Court of Canada, liquidity and the flow of funds are needed to minimize disruption on a project and ensure that contractors and subcontractors performing work are paid for their work. Fortunately, the provincial lien legislation provides a solution to this problem: the posting of security by a contractor. A contractor is able to vacate a claim for lien by posting security sufficient to pay the claim for lien, if the lien claimant is successful. Once the security is posted, this allows an owner to pay what it owes to the contractor, without fear that a lien claimant will later come after the owner for improperly releasing funds.

The use of lien bonds as security to vacate liens is common-place on construction projects throughout Canada. Lien bonds have become the *de facto* security posted by contractors, and for good reason: lien bonds are essentially credit facilities, issued by surety companies, which are regulated financial institutions, and are payable on demand by the court to the lien claimant. By using a lien bond, a contractor can receive payment from an owner, without tying up its cash in a dispute with a subcontractor that may take years to resolve.

The recent decision of the Manitoba Court of the Queen's Bench in *Bird Construction Group v. Trotter and Morton Industrial Contracting Inc.* 2021 MBQB 233 (*Bird v TM*) addressed the use of lien bonds on municipal projects. The Court ultimately rejected the use of lien bonds on "Crown Lands", and in doing so, threatens to upend the well-established use of lien bonds as effective security to vacate claims for lien. Respectfully, as set out below, the decision of the Court cannot withstand scrutiny.

The Court Decision

The facts of the *Bird v TM* decision are not particularly unique. Bird Construction Group (Bird) was the general contractor on a project known as the "City of Selkirk Wastewater Treatment Plant". A dispute arose between Bird and one of its subcontractors, Trotter and Morton Industrial Contracting Inc. (TM). As a result, TM registered two claims for lien, the first of which claimed $2,347,098.03. Although Bird denied that it owed money to TM, it was prepared to post two lien bonds to vacate TM's claims for lien, in order to "ensure the Project proceeds and minimize disruption to the Project".

TM opposed the use of a lien bond for the first claim for lien, although it was prepared to accept a lien bond for its second claim for lien. TM argued that it would be inequitable for Bird to post a lien bond and, as a result, Bird should not be allowed to do so. The Court ultimately agreed with TM, although its reasoning appears to stray from the positions advanced by TM.

First, the Court referred to s. 55(2) of the Manitoba *Builders' Liens Act*, C.C.S.M. c. B91 (the Act), which provides as follows:

> **Vacating lien on payment into court, etc.**
>
> 55(2) Upon application, a judge may order security or payment into court in an amount equal to the holdback required under this Act as it applies to a particular contract and any additional money payable with respect to that contract but not yet paid but not exceeding the total amount of the claims for liens then registered against a parcel of land and may then order that the registration of those liens be vacated.

The Court then considered the impact of the application of this section to "Crown Land". In the normal course, a claim for lien acts as a charge against the property on which the construction work was performed. In the case of construction on land owned by the Crown, a Crown agency, or a municipality, such as the project in question, the lien does not act as a charge against the property. Rather, it acts as a charge against the legislative holdback an owner is required to maintain.

The Court held that this distinction created a "fundamental challenge" in accepting a lien bond to vacate a lien on Crown Land: In the case of Crown Land, because the charge was against holdback (*i.e.* a charge on cash), it was different than a charge against property. When property is charged, the process to enforce a claim for lien is "cumbersome" and requires a successful lien claimant, in the face of non-payment, to take steps to enforce the sale of the property to recover its judgment. In such a situation, a lien bond is easier to enforce and is "as good as, if not better than, a charge on the land against which the lien has been registered".

However, the Court reasoned that a lien bond was less effective in the case of a registration against Crown Lands, as it was not as good as cash:

> "When cash is deposited, the claimant need only apply to the court for payment out once it has obtained its judgment. In the case of a lien bond, there is always the risk that the credit worthiness of the surety will have diminished by the time of the judgment. Additionally, the successful judgment creditor must then take steps to enforce the lien bond against the surety. Most times that is not problematical. Sometimes it is."

The Court also reasoned that, because of the trust rights afford to subcontractors under the Act, the charge against holdback also operated as a "practical restraint" on the use of funds contrary to the trust provisions, which would be diminished by the use of lien bonds. As a result, the Court refused to accept the use of a lien bond for TM's first claim for lien, and required Bird to post cash security to vacate the lien.

A fundamental misunderstanding

It appears as though Bird has appealed the decision of the Court, which is scheduled to be heard by the Manitoba Court of Appeal on August 30, 2022. Respectfully, this is unsurprising given the fundamental misunderstanding by the Court about both the use of lien bonds and the trust provisions of the Act.

First, as acknowledged by the Court, there was no issue raised by TM with respect to the credit-worthiness on the part of the proposed surety. Given the federal and provincial regulation of surety companies in Canada, which require the sureties to demonstrate financial solvency and sufficient ability to respond to claims, the credit-worthiness of the proposed surety should not impact the assessment of the worthiness of the lien bond.

Second, TM did not take issue with the wording of the proposed lien bonds. The Court alluded to the prospect that a lien claimant may have difficulty enforcing the lien bond. Although the wording of the lien bond in the *Bird v TM* decision was not cited, the following represents the typical language used in lien bonds across Canada (emphasis added):

> The surety, in default of payment by the principal, shall pay to the obligee within such further time as is specified by the court, the amount of any deficiency in the payment by the principal but the surety is not liable to pay more than a total maximum amount of $ _. **The surety shall make such payment upon the written demand of the obligee without the right to question the merit of the demand and despite any objection by the principal.**

The "obligee" (*i.e.* beneficiary) under a lien bond is not the lien claimant, but rather the Court. The process for obtaining payment under the lien bond is similar to cash, and requires the lien claimant to obtain an order of the Court, which then makes a demand on the surety. The lien bond is payable on demand, and therefore the risk of "taking steps to enforce the lien bond" posed by the Court is, respectfully, unmerited. The lien bond *is* as good as cash.

Third, the proposed solution by the Court, to have Bird pay cash as security, demonstrates a fundamental misunderstanding over the purpose of a lien bond. The lien bond, as mentioned, is a credit instrument. Its purpose is to provide security to the lien claimant without the need for the contractor's liquidity to be tied up until the claim for lien is resolved, which can often take years. If a contractor were required to pay cash as security, there would simply be no point to vacating the claim for lien. Any funds released by the owner to the contractor once the cash security was paid into court would be offset by the funds paid by the contractor as security. This would therefore require the contractor to either (a) advance payment on the project in the amount of the claim for lien; or (b) result in the owner withholding funds from the contractor. In either situation, the flow of funds on the project is impacted, to the detriment of the owner, contractor, and other subtrades.

Fourth, the *Bird v TM* decision creates an artificial distinction between projects on Crown Lands and those on other property. The reason lien claimants are unable to register charges against Crown Lands is one of practicality. They are unable to enforce security against Crown Lands, as they could on other property. Quite simply, a lien claimant cannot enforce a court ordered sale of a wastewater treatment plant, road, etc. The intent of the Act was not to create two different tiers of liens. Rather, it was to address the mechanistic issues with enforcement of liens on Crown Lands, not to require different forms of security for different properties.

Finally, the Court suggests that the use of lien bonds may result in a potential breach of trust. This reasoning misconstrues the trust provisions of the Act and the impact of lien bonds. A lien bond simply acts as substitute security to the charge on holdback. It has no impact on the trust rights of a lien claimant or its ability to assert a trust claim. If a contractor posts cash as security to vacate a claim for lien, the trust funds on the project will be paid in the normal course to the contractor. Any rights a subcontractor would have with respect to the trust funds would still exist. Conversely, there would be no trust imposed on the funds paid by the contractor as security (indeed, as acknowledged by the Supreme Court of Canada in *Stuart Olson*, the trust and lien rights under the Act are distinct remedies). In this sense, the cash posted as security would be the same as the lien bond posted as security. Neither would be trust funds, and any trust rights of a subcontractor would not be impacted by the form of security posted.

Reading the *Bird v TM* decision in light of the above, it is our respectful view that the Court reached the wrong conclusion. Lien bonds can and should be used as security for claims for lien, regardless of whether the project is location on Crown Lands or not.

We will update this commentary after the release of the Court of Appeal decision.

For more information, please reach out to any of the key contacts below.

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